PRO-POOR ECONOMIC GROWTH RESEARCH STUDIES
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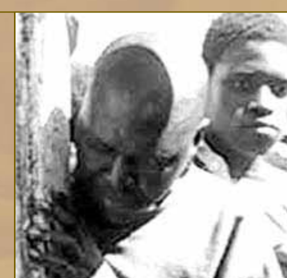
An Examination of the Changing Patterns of Growth and Poverty in Zambia, 1991-2000



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An Examination of the Changing Patterns of Growth and Poverty in Zambia, 1991-2000

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EXECUTIVE SUMMARY

The Zambian economy has experienced a severe decline in its fortunes since Independence in 1964: real GDP per capita has declined an astounding 42 percent and poverty incidence has increased, reaching 73 percent in 1998. The elections of 1991 ushered in the reformist-minded government of Chiluba, which was initially committed to undertaking deep reforms aimed at achieving sustainable growth and poverty reduction by transforming the Zambian economy from an inward-looking, state-dominated economy to an open, market-oriented, private sector driven economy.

The Chiluba government originally moved quickly forward with stabilization and certain aspects of structural adjustment and trade such as agricultural, and financial liberalization. By the mid-1990s, the fundamental aspects of the reforms had been put in place. The reforms had some positive effects on the economy: hyperinflation was arrested (although inflation continues to hover around 20 percent); there was some diversification of an originally mono-crop agricultural sector; and financial deepening seems to be occurring, driving growth in parts of the service sector. Overall, growth and poverty outcomes since the initiation of reform have been mixed: average annual real GDP per capita decreased by close to 2 percent between 1991 and 2000, and the poverty incidence increased by more than 3 percent over the same period. Although the average growth trend between 1991 and 2000 as a whole has been discouraging, there has been a slight increase in real GDP per capita growth in the latter half of the 1990s. The modest but continuing growth acceleration since 1998 provides some grounds for optimism.

One obvious factor in Zambia's poor economic performance over the decade has been the continuing decline in revenues from copper throughout the decade. The growth of the non-copper sector has, in fact, been reasonably impressive since mid-decade—it has grown an average of approximately 5.5 percent per annum over the 1995-2001 period. During the early 1990s, the overvaluation, high interest rates, and disarray in agricultural policy were no doubt contributors to the stagnation of the non-copper sector. By the latter part of the 1990s, the most negative of these effects had past and some of the benefits of stabilization and adjustment may have contributed to the decent growth that occurred. An additional drag on the economy's performance, albeit a hard one to measure quantitatively, has been the HIV/AIDS epidemic. Its negative impact probably increased as the decade went on.

Part of the blame for the weak GDP growth clearly lies with weaknesses in the design and implementation of Zambia's structural adjustment program (SAP). Little thought seemed to have been given to policy coordination and the proper pace and sequencing of reforms, so it was not uncommon for reforms that worked at cross purposes to be undertaken simultaneously.

The poor reform design was, in part, due to Zambia's adoption of the standard SAP model promoted by the IFIs at the time. This model was not tailored to the needs of the Zambian economy and was probably too simplistic: it merely pushed countries to stabilize and liberalize all sectors in short order. The example of trade liberalization in Zambia illustrates this point well. The total removal of protection during a time when the Kwacha was appreciating (as a result of the liberalization of the foreign exchange and capital markets) and neighboring countries were not complying with the negotiated trade agreements had a negative impact on the competitiveness of Zambian exporters. Zambia's experience calls into question the wisdom of failing to maintain some level of protection in the context of an appreciating and ultimately overvalued exchange rate and of trading partners that do not comply with trade agreements.

The absence of a built-in mechanism to allow Zambia to adjust to external shocks (such as droughts and declining copper prices), is further evidence of a lack of sophistication of the SAP. The 1992 drought was more damaging than necessary to the economy and to rural poor in particular because the government continued its strict stabilization measures rather than adjust them to account of the shock. Clearly, the lack of a sophisticated, coordinated reform policy able to adjust to external shocks was highly problematic.

Apart from design and implementation problems in policy areas they did address, the reforms failed to focus adequately on the crux of Zambia's problem: the dire need to diversify away from copper dependence. In addition to diversifying its exports, it was important that on a more fundamental level Zambia diversify the structure of its economy. Agriculture was rightly seen as the sector with the potential to be a driving force in the economy and to reducing rural poverty. Agricultural policy, however, has been characterized by a lack of clarity throughout the 1990s. In order for the agricultural sector to achieve its potential in terms of contributing to economic growth and poverty reduction a systematic and comprehensive agricultural policy must be developed.

The SAP program also suffered from the government's exaggerated expectations regarding the ability of the private sector to fill the vacuum of the retreating public sector. The more than two decades of socialist policies had resulted in a small and weak private sector. In addition, unexpected results of the reform such as the prohibitively high cost of credit severely limited the potential for the private sector to engage in productive activities while providing them incentives to channel their resources towards unproductive investments (i.e., high-yielding, low-risk Treasury bonds). Further, uncertainty regarding government policy (especially in the maize market where it would intervene unpredictably) further discouraged an effective private sector supply response. Since the success of the reform was predicated upon such a response the private sector's modest capacity limited Zambia's growth potential.

Additionally, increasing government corruption and waning government commitment to reforms undermined the potential growth and poverty reducing impact of the reforms. Corruption had a pernicious effect on the economy because it converted potentially productive and poverty reducing resources into unproductive rents. The government's diminishing commitment to reforms was evident by the mid-1990s. By that point, the reforms had borne little fruit. This contributed to the loss of government enthusiasm for them and thus increased the unevenness of their implementation.

Given all of these problems, how was Zambia able to achieve moderate growth in the non-copper sector since the mid-1990s? Is the growth trend sustainable? Recently, the service sector has been the main engine of growth of the Zambian economy. More specifically, the financial sector, retail and wholesale, and real estate have driven much of the non-copper sector's growth. Growth in the financial sector has come about as a result of the financial sector reforms, which facilitated the development of new forms and types of financial institutions and services. Growth in real estate has been a result of privatization, the Land Law of 1995, and the flight to non-financial assets because of the loss of confidence in local banks. It is interesting to note that despite the fact that the 1995 Land Law did little to solve the significant problems associated with property rights in Zambia, the little that it did accomplish had a big impact. Getting property rights and/or control rights straightened out in Zambia has the potential to spur significant growth. Privatization has opened up the wholesale and retail sub-sector to privately owned outlets, which are able to reach all of Zambia and offer a much wider variety of consumer goods than previously available. Informal sector trading has also grown tremendously as a result of import liberalization. Many of Zambia's urban poor were forced to participate in informal sector activities as a result of shrinking formal sector employment and the absence of a social safety net. While informal sector activities have not, on balance, been able to lower the incidence of urban poverty, they have contributed to the decreasing depth and severity of that poverty. Given the increasing incidence of urban poverty, it is important that Zambia develop a well-targeted social safety net.

Although the recent growth of the non-mining sector is encouraging, its sustainability and thus that of overall growth is unclear. The growth in financial services is a good sign and indicates that this sector may continue to grow. On the other hand, it is clear that Zambia cannot count on the continuation of the strong recent growth in retail and informal sector trade related to the one-shot effects of liberalization; in the medium and long run this sector's growth is closely tied to overall GDP growth. In order to achieve sustainable pro-poor growth the government will have to promote employment creation through the further diversification of the formal economy and a strengthening of the productive capacity of the informal sector.

To generate sustainable pro-poor growth Zambia must, among other things, develop non-traditional labor-intensive exports. Since, after copper, Zambia's comparative advantage lies in agriculture, promotion of that sector and the labor-intensive, export-oriented agro-processing industries will need to be an important component of pro-poor policy. It is critical, therefore, that Zambia develop a sound agricultural sector policy that is able to guide this sector's growth. Such a policy should get the prices (especially of credit and of maize) and incentives right, while recognizing the importance of investing in key public goods such as rural marketing, extension services, and infrastructure.

CHAPTER ONE
INTRODUCTION[1]

The story of Zambia's post-Independence economic decline is dramatic. It has been one of great promise, poor economic and political governance, deepening corruption, and missed opportunities. At Independence in 1964, the Zambian economy was one of the most prosperous in Sub-Saharan Africa: Zambians enjoyed one of the highest levels of per capita income and living standards in the region; and the country possessed extensive natural resources, including vast mineral deposits, arable land, and forest and fisheries. Despite the promise of the early post-Independence period, over the last three decades Zambia's economic decline has been striking: Zambia now ranks among the poorest countries of the world as reflected in its real per capita income of less than US$400 in 2000 (equivalent to approximately 59 percent of the level at Independence) and the extraordinarily high poverty incidence of 73 percent in 1998 (World Bank. *World Development Indicators* and CSO 1998). Interestingly, since last half of the 1990s Zambia has experienced modest growth in real GDP per capita.

Both exogenous and endogenous factors contributed to Zambia's economic decline, including the collapse of the copper market, the mid-1970s oil shock, and droughts. The situation was compounded by the failure of Zambia to adjust the structure of its economy and policies to reflect changed circumstances: the economy remained undiversified, exhibiting a dangerously high dependence on mineral resources, it maintained high levels of protection on its inefficient industries, and its macroeconomic policies were unsustainable. Further, because of the collapse of the copper market the Zambian government was no longer able to depend on mining for revenue and foreign exchange, so foreign borrowing was increased in an attempt to sustain the standard of living of the average Zambian. Consequently, by the mid-1980s Zambia had become one of the most indebted nations in the world relative to GDP and was faced with a balance of payments crisis. International financial institutions (IFIs) advocated stabilization and structural adjustment reforms. Zambia undertook these reforms in the 1980s, but "food riots" in the urban areas and resulting political pressures on the Kaunda government led to their being abandoned.

Under the newly elected reformist-minded government of President Frederick Chiluba, Zambia began implementing its stabilization and structural adjustment program (SAP) in 1991. The SAP aimed at liberalizing key markets, rationalizing the external debt, reorganizing and streamlining the public sector, privatizing the state-owned enterprises (SOEs), liberalizing the banking sector, and revitalizing the mining sector. Zambia moved aggressively on stabilization and structural reforms, including financial sector reform, and trade liberalization, but delayed some of the most critical components of adjustment such as public sector reform and privatization of the copper mines. This was problematic given that in the absence of reform, both the high wage bill from the public sector and the costs of running the copper mines contributed to continued high quasi-fiscal deficits and dampened Zambia's growth potential.

[1] My sincere gratitude goes to John Harris and Al Berry for their insightful and thorough comments. I also greatly appreciate the support of the USAID/Zambia officials with whom I had thoughtful discussions. Finally, I would like to express my deep appreciation to the many people who generously gave of their time while I was in Zambia. I bear full responsibility for the substance of the work.

The patterns of growth and poverty since the initiation of the reforms have been mixed: average annual real GDP per capita decreased by close to 2 percent between 1991 and 2000 and the poverty incidence increased by more than 3 percent over the same period. Most studies that examine Zambia's economic performance in the 1990s focus solely on its (admittedly poor) average performance over the decade. However, looking beyond the decanal average reveals an interesting trend: there has been a slight positive growth trend (.30 percent increase per annum) between 1995 and 2000. The modest but continuing growth acceleration since 1998 provides some grounds for optimism. This paper will thus examine the following questions: what factors contributed to Zambia's particularly poor economic performance in the first half of the 1990s and the associated increase in poverty? What explains the apparent turnaround evidenced by the mildly increasing GDP per capita in the latter half of the 1990s? In particular, what role, if any, has policy reform played in bringing about the better performance? Is the positive growth trend of the last few years sustainable?

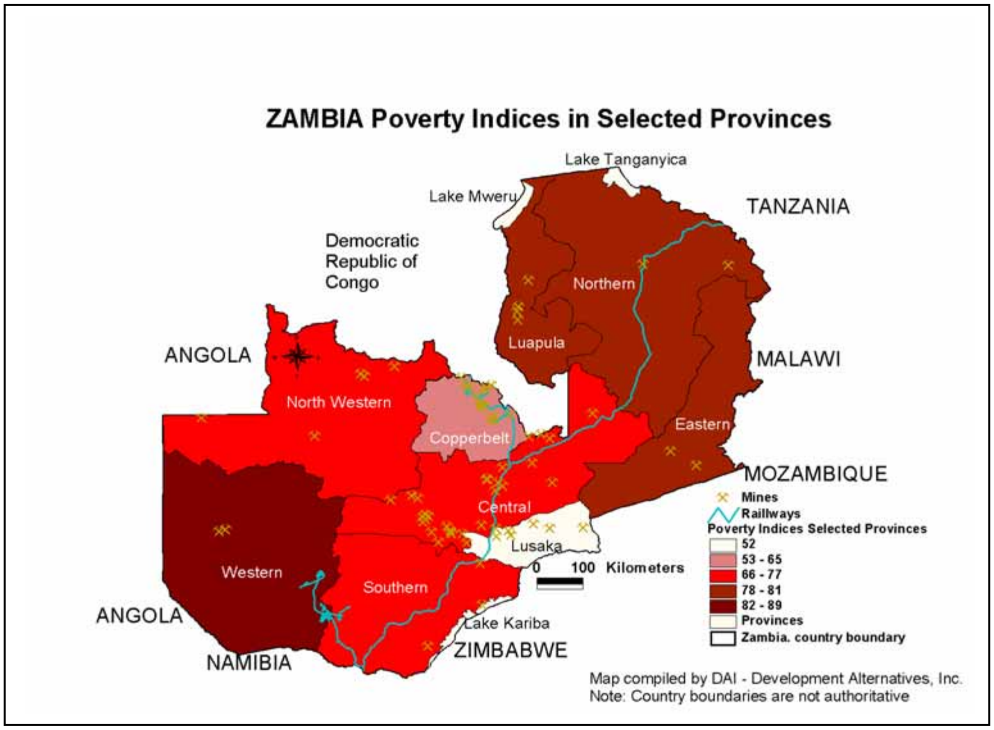
One powerful negative factor depressing Zambia's growth and poverty reduction potential is HIV/AIDS. Its prevalence rate in Zambia is estimated to be between 16 and 19 percent, one of the highest in the region (CBOH 2002). A recent study suggests that the rate of economic growth has decreased by 2 to 4 percent in Sub-Saharan Africa as a result of HIV/AIDS. While no studies exist that have calculated the economic impact of HIV/AIDS in Zambia, it is clear that it is proving to be among Zambia's greatest challenges this century. The epidemic destroys both human and social capital, leading to profoundly negative effects on both the Zambian economy and society. For example, it compromises Zambian competitiveness because it negatively impacts labor productivity in all sectors,[2] increases the cost of doing business as absenteeism and worker turnover increases as workers get sick. Human capital formation, critical to growth and long-term poverty reduction, is also threatened as teachers are dying faster than new ones can be trained (DAI 2002). In addition, HIV/AIDS has resulted in diminished capacity at all levels of the civil service, including key positions in the ministries. It has also led to an increased number of dependents per household, forcing households to further divide already scarce resources, pushing them deeper into poverty and into poverty traps. The explosion in the number of orphans also has serious implications for Zambia's social fabric for generations to come.

This paper analyzes the evolution of poverty in Zambia since liberalization in 1991. The first section discusses the changing politico-economic context in Zambia since Independence. The second section provides evidence on poverty, growth, and income distribution in Zambia's in the 1990s. The next section seeks to explain the pattern of growth and poverty over the 1990s. In particular, it seeks to understand what sectors contributed to the growth that the Zambian economy has experienced since 1995; whether the trend is sustainable; and to what extent, if any, policy reform and its implementation influenced the pattern of growth and poverty since 1991. The study concludes with a section drawing lessons learned from the experience of Zambia.

[2] A report from a USAID/Zambia sponsored project in peri-urban areas suggests that recently the number of days an average household works in a year had fallen dramatically from 800 to 500. It also found that some farms are completely abandoned due to HIV/AIDS related health problems (DAI 2002 cited in USAID/Zambia 2003).

CHAPTER TWO
THE SETTING

GEOGRAPHY AND DEMOGRAPHICS



Zambia, a landlocked country in South Central Africa, is bordered by Angola, the Democratic Republic of Congo, Malawi, Mozambique, Zimbabwe, Namibia, and Tanzania. Over the past three decades, many of its neighbors have experienced civil conflict and/or severe repression. Zambia, however, has avoided both.

The country is generously endowed with natural resources, including mineral deposits, arable land (75 million hectares, approximately 9 million hectares of which are suitable for agricultural production), and vast forestry and fisheries.[3] It possesses four agro-ecological zones: the North is characterized by high rainfall, but poor infrastructure; the South has better soils than the North and good infrastructure; the Western zone has sandy soils and poor infrastructure; and the Eastern zone possesses relatively good infrastructure, but is drought prone (Milimo et al. 2001).

Zambia is divided into nine administrative provinces (see map) and 72 districts. Its population, which registered approximately 10.3 million in 2001, is highly urbanized given the low per capita income level (nearly 40 percent of the population live in urban areas), and is largely concentrated along the line-of-rail that links the Copperbelt in the North with Lusaka, the capital, and the border town of Livingstone in the South. The high level of urbanization can be traced to the government's policy of subsidizing urban food prices; its neglect of the agricultural sector; employment opportunities in the massive public sector; and the relatively high-wage formal

[3] Zambia possesses approximately .9 hectares of arable land per capita. This is relatively high when compared to other African countries. Recently, infrastructure constraints and lack of adequate farm labor have resulted in only 14 percent of arable land being cultivated (World Bank 2003).

sector employment in urban areas (World Bank 1994).[4] Interestingly, as will be discussed later, the map shows that the poorest provinces are located furthest away from mining areas and the line-of- rail.[5] The roads and railroad are now in disrepair, resulting in high transport costs. Communication costs are also high owing to poor communications systems. Zambia's competitive position is therefore severely weakened by the fact that it is landlocked, drought prone, and has extremely high transport and communication costs.

[4] Similar to other high-rent economies, Zambia developed a large public sector post-Independence. Indeed, the public sector constituted the largest formal sector employer. In 1991, it still employed more than 25 percent of those employed in the formal sector (Rakner et al. 2001; McCulloch et al. 2003).

[5] Poverty incidence estimates are for the year 1998 and are from CSO (1998).

CHAPTER THREE
THE EVOLUTION OF THE ZAMBIAN POLITICAL ECONOMY, 1964-2002

ESTABLISHMENT OF A SOCIALIST ECONOMIC SYSTEM, PROSPERITY, COLLAPSE, AND REFORM

In 1964, Zambians gained Independence from the British and elected Kenneth Kaunda Prime Minister.[6] Kaunda set out to unify the country and build a modern nation state. As mentioned previously, shortly after Independence the Zambian economy was one of the most promising in Sub-Saharan Africa. At Independence, the Zambian economy was dominated by the copper sector; it accounted for 45 percent of GDP, 65 percent of public revenue, and 90 percent of exports. By contrast, the contribution of the agricultural and manufacturing sectors to exports stood at .4 and .26 percent, respectively and their value added represented 16 percent of GDP for agriculture and 7 percent of GDP for manufacturing (World Bank 2003 and *World Development Indicators*).

At Independence, the distribution of income appears to have been rather inequitable, judging by a World Bank (1994) estimate the Gini coefficient stood at 0.48. The majority of Zambians were employed in subsistence agriculture, while a small share of the labor force (a "labor aristocracy") was employed in formal sector mining, manufacturing, and urban (mainly government) services at relatively high wages.[7]

The newly elected Zambian government took it upon itself to tackle these inequities and grow the economy through a series of interventionist policies. Income from Zambia's mineral resources was used to build schools, roads, hospitals and other public facilities in urban areas and to provide free access to them. Maize and staple food subsidies were also provided. Income derived from copper was also used to support growth in industry and the public sector. The strategy aimed to increase government provision of goods and services, nationalize major industries, and Zambianize formal sector employment (ibid.).

The early years following Independence can be characterized as fairly liberal politically and economically, however, by the late 1960s-early 1970s the government began to impose an increasingly restrictive and interventionist environment. The Mulungushi Declaration of 1968 ushered in a period of import-substitution industrialization, state-led, socialist-oriented policies in Zambia. Specifically, the government's strategy:

- Limited the degree of competition (both internal and external);
- Suppressed the role of market mechanisms;
- Expanded the role of the public sector; and
- Provided heavy protection for the manufacturing sector (ibid).

[6] This title was later changed to President.

[7] At Independence, the copper sub-sector was largely controlled by non-Zambians (World Bank 1994). It was nationalized shortly after by Kaunda's government. It is important to note that the Gini coefficient referred to Zambians so the fact that a lot of copper income went to non-nationals was not one of the factors in the high level of inequality.

This policy, which remained intact until 1989, led to a rapid expansion of public sector, distortions in domestic markets, and a significant weakening of the private sector. In addition, a capital-intensive growth path was encouraged through low tariffs on capital goods, low interest rates, high private sector wages relative to other countries in the region, and an overvalued Kwacha.

The government's strategy continued the pre-Independence pattern of dependence on copper. Virtually every aspect of the economy was organized to support copper mining. The government's promotion of maize production and intervention in the maize markets provides a good example of this policy. Since maize production was considered essential to keeping the mining towns fed at a low cost, the government intervened in the market, providing producer subsidies for fertilizer and maize seed and purchasing the maize through the National Agricultural Marketing Board (NAMBoard) at a centrally-determined price.[8] "Agricultural research and extension efforts were largely aimed at maize producers and internal maize prices were raised relative to those of alternative crops. There was also an evident policy bias in favor of commercial farmers, located along the line-of-rail and occupying the most productive lands" (World Bank 1994: 80). The maize was transferred along the line-of-rail to mining towns and other urban areas where consumers purchased it at subsidized prices.

The government's promotion of maize production to support the copper industry at the expense of the rest of the agricultural sector not only bore an extremely high fiscal cost, but also had serious long-term negative effects on the development of the agricultural sector and ultimately Zambian development. In 1976, the Zambian government spent approximately 2.9 percent of GDP on these transfers. By 1988, the maize subsidy bill had increased to a crippling 4.7 percent of GDP (Wichern et al 1999). Due to the distorting effect of the subsidies and the high cost to the budget, the government came under pressure from IFIs and donors to remove them.[9] In addition to being a huge burden on the budget, the producer subsidies distorted the agricultural market, resulting in maize being produced in unsuitable areas and biasing the direction of research away from high value export crops to staples with low social profitability (Deininger and Olinto 2000).

Copper prices collapsed by the mid-1970s, creating an enormous adverse shock on the Zambian economy (see Figure 1). Export revenues further decreased due to declining ore grades and decreasing production levels (Rakner et al. 2001). Yet, the economy remained heavily dependent on the copper sector because the other sectors were undeveloped, in part, due to the nationalization of assets outside of the mining sector and the government's neglect of agriculture (World Bank 2003).[10] Indeed, rather than channeling rents derived from mining into the development of sectors and of human capacity that would help diversify the economy and thus make it less vulnerable to external shocks to the mining industry, rents were used to grease the

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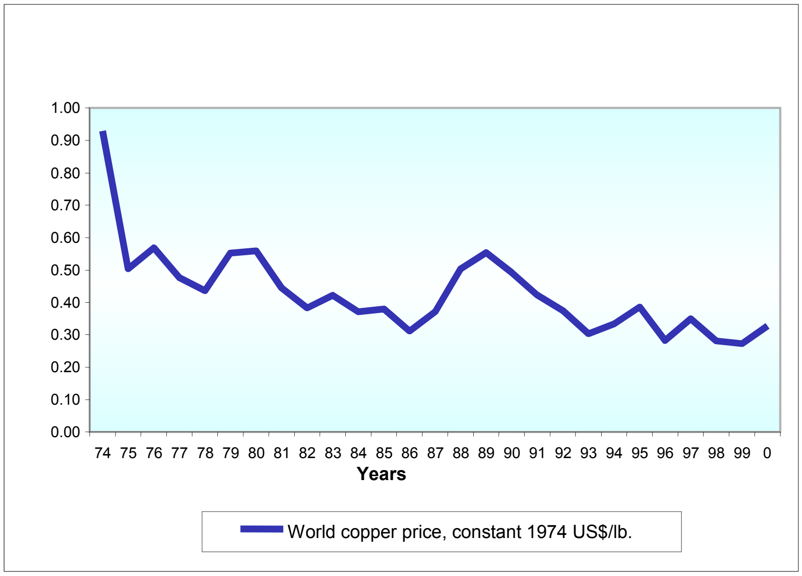
8 The National Agricultural Marketing Board (NAMBoard), established in 1969, held a monopsony position and bought all agricultural products (with the exception of cotton, milk, beef, pork, and horticultural products) from producers. NAMBoard established pan-territorial pricing for maize and maize products in 1974-5. The result was the dominance of maize production in the agricultural sector (Rakner et al. 2001). According to the World Bank (1994), maize represented 70 percent of land cropped and 85 percent of crop production.

9 As will be discussed, maize (and food subsidies in general) has become a politically charged issue as Zambians have come to expect the government to provide such entitlements.

10 By 1995, mining still represented nearly 87 percent of Zambia's merchandise exports.

wheels of Zambia's patrimonial political system and to maintain urban dwellers standard of living.

Figure 1: World Copper Prices, 1974-2000



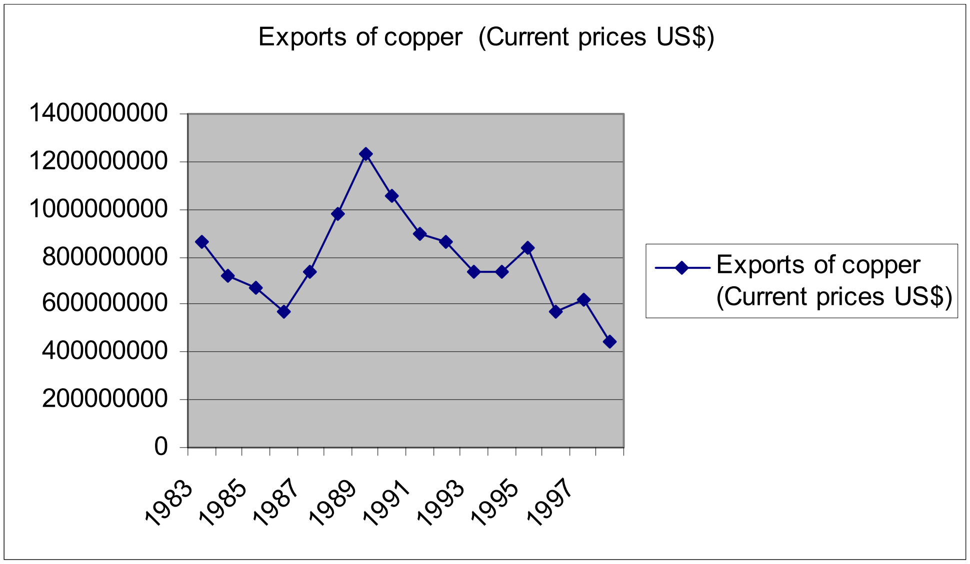
Source: World Bank. 2001. *World Development Indicators,* CD-Rom.

From 1975 onward, Zambia increased its foreign borrowing in order to maintain the subsidy system and Zambian's standard of living. Between 1970 and 1976 external debt had more than doubled from $813 million to almost $1.9 billion, resulting in a severe balance of payments crisis. Despite this apparently bleak picture, the Kaunda government as well as the World Bank and major bilateral donors were optimistic about the prospects of the copper market recovering. As a result, Zambia did not make the necessary adjustments to its development strategy. Instead, the government continued its external borrowing to finance consumption, failed to devalue the exchange rate, and maintained its bloated, revenue-draining public sector (World Bank 1994). But copper export revenues continued to plummet (see Figure 2). By 1986, Zambia was faced with GDP per capita that had been on the decline for a decade, a serious debt problem, and rapidly rising inflation (see Table 1).

Structural Adjustment Attempted and Abandoned and Multiparty Elections Held

Kaunda's government attempted a structural adjustment program in 1985, which included a weekly auction of the Kwacha. This resulted in a very sharp depreciation of the Kwacha (see Figure 3) and then more inflation which nullified the real depreciation. There were also attempts to remove subsidies on foodstuffs, but these provoked riots in the Copperbelt and Lusaka. The Kaunda government abandoned the structural adjustment reforms in 1987 and

Figure 2: Exports of Copper (current prices US$), 1983-2000



Source: World Bank. Various Years.

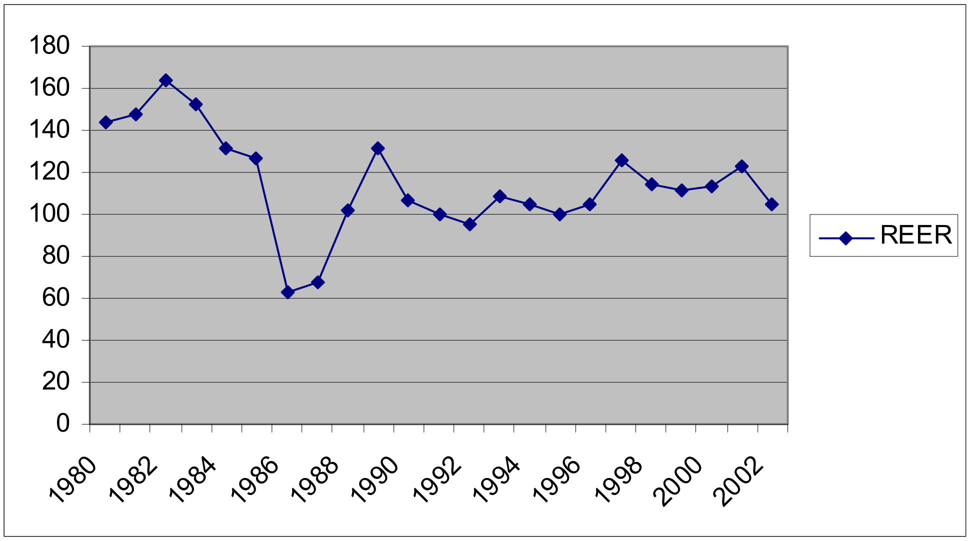
Table 1: Selected Economic and Demographic Indicators, 1970-1989

	1970-1975*	1975-1980*	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
GDP per capita (constant Kwacha)	439814	400514	367589	377831	355778	338170	326975	322492	315363	314382	324342	311473
Total Debt Service (% of exports)	n.a.	31[a]	25	36	31	29	25	16	52	19	15	3
Inflation	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	56	47	51	123

*Average over the period indicated.
[a.] 1978
Source: World Bank. *World Development Indicators*, CD-Rom.

launched the "Growth from Own Resources," campaign. This campaign restricted debt payments to 10 percent of Zambia's export earnings. Table 1 shows the sharp decrease in total debt service beginning in 1987. Donors responded by decreasing their aid to Zambia and levying penalties on it, which further increased the stock of Zambia's external debt (JCTR 5). Ultimately, the magnitude of the economic crisis and escalating international debt forced Zambia to enter into new aid agreements with the IFIs (Rakner et al. 2001). By 1990, Zambia cut subsidies on foodstuff and introduced user fees in schools, colleges, and hospitals. This sparked food riots and widespread protests in Zambia. Increasingly vocal dissatisfaction with Kaunda's government and his United National Independence Party (UNIP) resulted in a call for multiparty elections. Elections were held in 1991 and Frederick Chiluba, a trade unionist, leader of the Movement for Multiparty Democracy (MMD), and self-proclaimed reformer, emerged as the victor.

Figure 3: Real Exchange Rate, 1980-2002



Source: IMF. *International Financial Statistics*.

Stabilization and Structural Adjustment under the Chiluba Government

By 1991, Zambia began implementing a conventional stabilization and structural adjustment program (SAP). The SAP was relatively standard and included: decontrol of agricultural prices and liberalization of maize marketing; reduction of the size of the public sector; removal of exchange controls and floating of the Kwacha; rationalizing the external debt; privatization of state-owned enterprises (SOEs); trade liberalization; and liberalization of the banking sector.

As shown in Figure 3, after the liberalization of the exchange rate system in 1991, the real exchange rate (REER) in this Dutch Disease country achieved some depreciation amidst fluctuations. Since bottoming out around 1992 there has been a reversal, though the most recent change has been downward turn registered in 2002. The considerable volatility, at times extreme, has adverse impacts on the economy in general and efforts to export in particular.

Since the 1970s Zambia's growth has not nearly kept pace with population growth, leading to a the significant decline in per capita income (more than 50 percent in real terms between 1970 and 2000) and a deteriorating poverty profile (as will be discussed in the next section).[11]
Table 2 shows that despite the initiation of SAP in 1991, real GDP growth in Zambia has been weak and volatile, averaging .62 percent per annum over the 1990s. Between 1995 and 2000, average annual growth increased to 2.69.[12] According to the Economist Intelligence Unit (2003) estimates, Zambia registered close to 3 percent GDP growth in 2002, making it the first time in

[11] Real per capita GDP in 1970 was approximately $722 (constant 1995 US$), while in 1990 it was $376 (constant 1995 US$) (World Bank. *World Development Indicators)*.
[12] Section IV will investigate which factors contributed to this increase in the latter part of the 1990s and whether the increase is likely to be sustainable.

over two decades that growth has been positive for four consecutive years. Since 2000 these rates have been boosted by the privatization of Zambia Consolidated Copper Mines (ZCCM) (Zambia's largest copper mine), which has resulted in new investments and increased output in the sector (EIU 2002).[13] On another relatively positive note, inflation while still high has remained relatively consistent, averaging 25.5 percent between 1997 and 2000.

Table 2: Zambia—Selected Economic and Demographic Indicators, 1990-2000

Indicator	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth, real (annual %)	-0.5	0.0	-1.7	6.8	-8.7	-2.5	6.6	3.3	-1.9	2.0	3.5	5
GDP per capita, (constant Kwacha)	300527	291491	278102	288689	256352	243296	252735	254744	244245	243746	247012	255045
Current account balance (% of GDP)	-12.0	-15.0	-24.0	-14.0	-12.0	-13.0	-13.0	-11.0	-15.0	-18.0	-17.0	n.a.
Total debt service (% of exports of goods and services)	15.0	47.0	27.0	31.0	29.0	181	20	19	21	16	20	12
Foreign direct investment (%GDP)	6.16	1.0	1.4	1.6	1.7	2.8	3.4	5.3	6.1	5.8	3.76	1.98
Gross domestic investment (% of GDP)	17.3	11.0	11.9	15.0	8.2	15.9	12.8	14.6	16.4	17.9	18.3	n.a.
Gross domestic savings (% of GDP)	16.6	8.4	0.0	9.0	7.4	12.2	5.3	9.4	3.9	-0.9	8.29	9.8
Lending interest rate	35.1	n.a.	54.6	113.3	70.6	45.5	53.8	46.7	31.8	40.5	38.8	46.2
Inflation, consumer prices (annual %)	107.0	93.2	169.0	188.1	53.6	34.2	46.3	24.8	24.0	27.0	26.0	n.a.
Overall fiscal deficit, incl. Grants (% of GDP)	-13	-16	-13	-14	-12	-10	-7	-5	-10	-10	n.a.	n.a.
Formal sector employment	n.a.	17	n.a.	n.a.	n.a.	15	13	15	12	10	n.a.	n.a.
Population, total	7.8	8.0	8.3	8.5	8.7	9.0	9.2	9.4	9.7	9.9	10.1	10.3
Population, growth	3.1	3.0	2.9	2.9	2.8	2.7	2.6	2.5	2.3	2.2	2.1	2.0

Source: World Bank. 2001; World Bank. *World Development Indicators, Cd-Rom; World* Bank. Various years. *SIMA and Region Database.;* IMF. Various years. *Government Finance Statistics*.

Since the 1980s when Zambia became one of the world's most indebted nations relative to its GDP, its external debt has remained enormous, peaking at US$7.05 billion at the end of 1996 (World Bank 2002). The service on this debt absorbs a significant share of resources meant for critical development programs.

As shown in Table 2, during the 1990s, Zambia's debt service averaged more than 36 percent of exports of goods and services, rising to a peak of 181 percent in 1995. These extremely high obligations compromised Zambia's ability to invest and grow. The debt overhang meant that the "government [was] forced to focus on short-run measures to ensure sufficient foreign exchange, making Zambia highly dependent on foreign assistance" (World Bank 1994: 79). Between 1991 and 1995, net annual official development assistance (ODA) receipts more than doubled the levels of the 1980s, averaging over $1 billion (World Bank 2002). In the second half of the 1990s, however, concerns over political governance and perceived waning commitment of the government to economic reform led donors to halve aid to Zambia (ibid.). Although net transfers

[13] As will be discussed, the company that purchased ZCCM pulled out in 2002, leaving ZCCM's fate in question.

remained positive in the latter part of the 1990s, they decreased considerably. During the 1990s, the amount of external debt service paid by the Zambian government exceeded net transfers. Thus, the development benefit of net official resource flows in the 1990s was insignificant. Clearly, the burden of the earlier profligacy continued to weigh heavily on the country.

Table 3: Net Transfers on Debt and AID, 1970-2000 (US$ millions)

	1970	1980	1991-1995	1996-2000
Net Transfers on LT and ST debt, incl. IMF	287	282	-90	-129
Of which: net transfers on IBRD/IDA	-2	-20	49	108
Official capital grants	0	23	430	224
Net transfers on debt and aid	287	305	340	95
Note: Total debt service paid	0	25	607	348

Source: World Bank. 2002.

In 1996, the IMF and World Bank launched a new debt reduction mechanism for Zambia and 40 other indebted poor countries, namely, the Heavily Indebted Poor Countries (HIPC) Initiative on debt. Access to HIPC funds was tied to Zambia's development and successful implementation of a Poverty Reduction Strategy Paper (PRSP). Zambia qualified for HIPC debt relief in December 2000, after having initiated its PRSP. Despite the relief that Zambia may get under the HIPC Initiative, estimated at about US$3.8 billion, debt and thus debt servicing will still remain very high. The EIU (2002) points out that "There is a structural foreign debt problem in Zambia; even with the enhanced HIPC relief on offer, it appears unlikely that export earnings can rise sufficiently to repay all the debt, particularly as more debt is being contracted" (29). Furthermore, there is some concern regarding the pressure to use those funds freed by debt relief exclusively on the social sector, including education, health, and social safety nets and not on sectors (i.e., agriculture) that have the potential to generate badly needed growth, income, and thus poverty reduction in the short term.[14]

[14] In the case of Zambia, the category of social expenditures also includes water, sanitation, and disaster relief (IMF/IDA 2001).

CHAPTER FOUR
POVERTY PROFILE[15]

INCIDENCE, DEGREE, AND LOCATION OF POVERTY

The proportion of the population living below the poverty line in Zambia is among the highest in the world (UNDP 2001); the incidence was estimated to be 73 percent in 1998.[16] Even more distressing is the fact that since 1991 poverty incidence and the level of inequality as evidenced by the Gini coefficient have increased (see Table 4).[17] More recently, the percentage of poor persons increased by more than 3 percentage points from about 69 percent in 1996 to almost 73 percent in 1998. This overall change is attributable to the 10 percent rise in urban poverty during the three-year period. This picture shows that urban poverty levels are quickly catching up to those of rural areas. On the other hand, poverty depth and severity between 1991 and 1998 have decreased, suggesting that some of the changes that have occurred over this period have had a pro-poor element. Nonetheless, it is important to note that while overall poverty depth and severity may have decreased during this period, they are still high relative to many other developing countries.[18]

Zambia is, by Sub-Saharan standards, highly urbanized; approximately 40 percent of its population lives in urban areas. It is therefore instructive to examine the differences in the incidence of poverty between the rural and urban areas. Table 4 shows that, as in virtually all countries, the incidence of poverty in rural areas is significantly higher than that of urban areas. Furthermore, the distribution of poverty is such that the majority of Zambia's poor live in rural areas where poverty is substantially deeper and more severe than in urban areas (see Figure 4). Interestingly, the trends in rural and urban poverty over the 1991 to 1998 period have diverged: poverty has increased from 48.6 percent to 56 percent in urban areas and decreased from 88 percent to 83 percent in rural areas.

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[15] This section is adapted from DAI (2002). *The Development Context of Zambia: An Update and Analysis, with Lessons Learned and Recommendations for USAID's Next Strategy Plan.*

[16] The Zambian Central Statistics Office (CSO) defines the poverty line as the amount of monthly income required to purchase basic food to meet the minimum caloric requirement for a family of six (equivalent to 12,300 calories per family).

[17] The year 1991 is chosen as a baseline year because the systematic monitoring of poverty levels began with the Priority Survey of 1991.

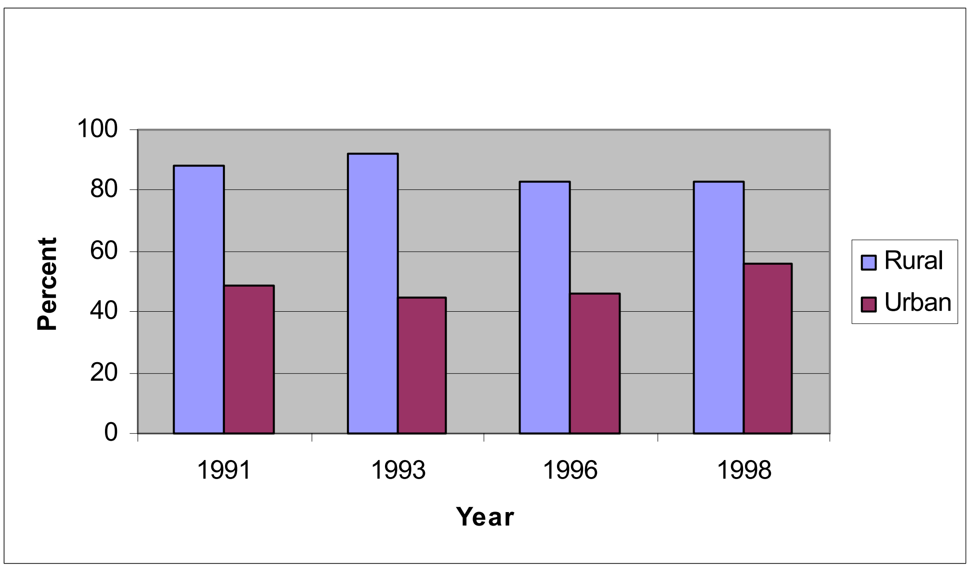
[18] The incidence of poverty ("headcount index") refers to the share of the population whose income or expenditure is below the poverty line, while the depth of poverty ("poverty gap") is a measure of the average gap between expenditure or income of poor households and the poverty line. Finally, severity of poverty (squared poverty gap) takes into account not only the distance separating the poor from the poverty line (the poverty gap) but the inequality among the poor. This measure places a higher weight on those households that are further away from the poverty line. Consequently, the higher the value of the measure, the more severe the poverty.

Table 4: Incidence, Depth, and Severity of Poverty by Rural/Urban Classification, Percent Change between 1991 and 1998, and Gini Coefficient

	1991	1993[19]	1996	1998	Percent Change (1991-1998)
Poverty Incidence					
All Zambia	.697	.738	.692	.73	3.3
Rural	.88	.922	.828	.83	-5.0
Urban	.486	.449	.46	.56	7.4
Poverty Depth					
All Zambia	.622	.583	.513	.55	-7.2
Rural	.697	.653	.556	.60	-.7
Urban	.464	.354	.379	.43	-3.4
Poverty Severity					
All Zambia	.466	.405	.323	.37	-9.6
Rural	.546	.476	.365	.42	-12.6
Urban	.299	.174	.194	.24	-5.9
Gini Coefficient*	.59	.61	.61	.66	

Source: CSO. 1991; CSO. 1993.; CSO. 1996; CSO. 1998.
*Note: The Gini Coefficient estimates are of household income.

Figure 4: Rural-Urban Distribution of Poverty[20]



Source: CSO. 1997; CSO. 1998.

[19] The 1993 survey was conducted at a different time of the year than the 1991, 1996, and 1998 surveys. Therefore, it is not clear whether the poverty estimates from 1993 capture long-term trends or seasonal variation. The 1993 poverty estimates may *not* be comparable to the poverty estimates and should therefore be interpreted with caution.

[20] The distribution of poverty refers to the percentage distribution of poor persons in a particular category (e.g., rural and urban).

It is instructive to determine the most impoverished areas in Zambia. As shown in Table 4, the level of poverty is higher in rural areas than in urban areas. Table 5 gives a more detailed picture of the location of poverty in 1998. Generally speaking, the farther a province is from an urban center and the line-of-rail, the poorer it tends to be. More specifically, Eastern, Luapula, Northern, and Western provinces demonstrated the highest incidence of poverty, with all of these provinces possessing poverty incidence levels of 80 percent and higher. While the *level* of poverty is highest in these provinces, because the population inhabiting Luapula and Western provinces in particular is relatively small (as indicated by the poverty distribution indicator in Table 5), the actual number of people living in poverty in Luapula and Western Province is not as great as the number of poor in Southern and Central Provinces.

Table 5: Poverty Incidence and Distribution by Province 1998

Province	Poverty Incidence	Poverty Distribution
Central Province	77	10
Copperbelt Province	65	18
Eastern Province	80	13
Luapula Province	81	7
Lusaka Province	52	15
Northern Province	81	12
Northwestern Province	76	5
Southern Province	76	13
Western Province	89	7

Source: CSO. 1998; CSO. 1997.

Wages as an Indicator of Poverty

It is impossible to trace the pattern of poverty prior to 1991 through direct use of the standard poverty indicators because comparable data do not exist to permit their calculation. However, changes in real wages can provide an indication of changes in income and thus in poverty between 1965 and 1991.[21] Table 6 demonstrates that the secular decline in real formal sector wages began in the early to mid-1970s in all sectors, and pre-dated the decline in per capita income (see Figure 5). Between 1965 and 1970 real earnings increased by 2.7 percent. By 1977, however, real wages had fallen sharply. Over the 1965 to 1992 period, average annual earnings across all sectors fell by approximately 78 percent. This is a catastrophic decline and implies a quantum jump in poverty during this period. The relative gain in the agriculture sector in the 1980s was lost by the 1990s. Recent estimates show that real formal sector wages in the private sector declined more than 40 percent between 1995 and 1997(McCulloch et al. 2003).

[21] It is important to note that only a small percentage of the Zambian population derive wage income from the formal sector. Most of those employed in the formal sector -- Zambia's "labor aristocracy" -- have historically been employed in mining, manufacturing, civil service, and urban services. The World Bank (1994) reports that formal sector employment stood at nearly 24 percent in 1980 and declined to less than 10 percent by the late 1990s. Although these data may only refer to a small share of the population, it is reasonable to expect the trends to be similar across groups.

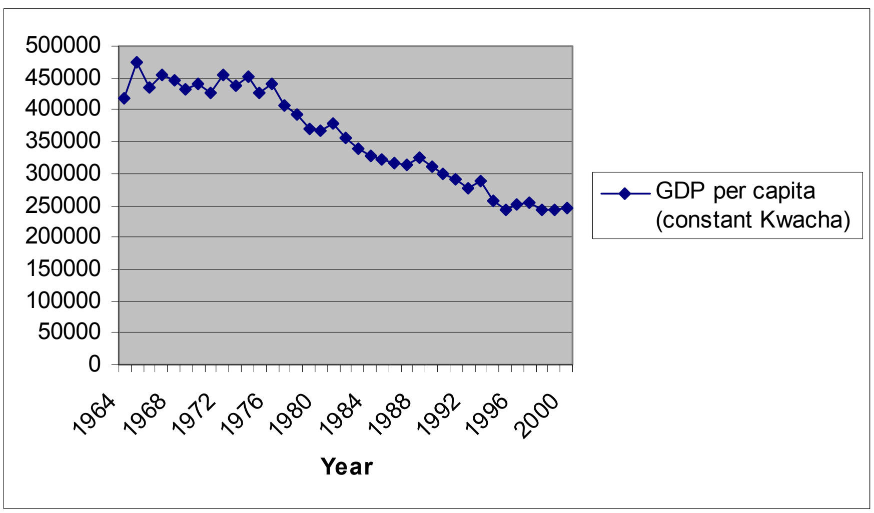
Table 6: Average Annual Real Earnings of Employees by Sector (Index 1975=100)[22]

	Agriculture, Food, and Fisheries	Mining & Quarrying	Manufacturing	Construction	Transport & Communications	Services
1965	90	110	100	84	75	99
1970	139	126	111	119	102	103
1975 (4thQ)	100	100	100	100	100	76
1977June	111	71	78	78	69	73
1979(2ndQ)	118	63	72	n.a.	n.a.	73
1980(2ndQ)	119	62	71	n.a.	n.a.	69
1986 2ndQ	136	36	37	n.a.	n.a.	40
1991Dec	48	34	25	46	26	26
1992 March	22	22	23	30	20	20

Source: World Bank. 1994.

Figure 5 shows that real per capita GDP over the 1965 to 1992 period displays a similar secular decline further supporting the assertion that poverty has continued to increase over the last three decades. Real GDP per capita has decreased approximately 42 percent since Independence. Between 1975 and 1995 the decline in real GDP per capita was at its highest, registering a decline of more than 43 percent. By the last half of the1990s, Zambia experienced a slight increase in real GDP per capita, seemingly arresting the secular decline.[23]

Figure 5: Changes in GDP per capita (constant Kwacha), 1964-2000



Source: World Bank. *World Development Indicators, Cd-Rom.*

[22] Wages reported are for the formal sector employees.

[23] It is interesting to note that if we compare Table 6 and Figure 5, it seems that wages fell by far more than GDP per capita. This could be a sign of data problems, but it could also reflect the fact that maize prices, which were important for real wages, rose sharply. As these wages refer to formal sector workers who tend to be better off, the decline in real wages might signal a shift in the distribution of income. On the other hand, changes in the income of other groups may have offset the impact of the decline in formal sector workers' real wages on Zambia's income distribution. While there is an inconsistency in the data, it clearly does not affect the big picture conclusion that since Independence there has been a dramatic fall in incomes and hence an increase in poverty.

Table 7: Summary Table Relating Growth, Poverty Incidence, Gini Coefficient, and Real Wages, 1964-2000

	Annual Rate of real Growth/capita	Poverty Incidence	Gini Coefficient[a]	Real Wage
1964-1975	.20	n.a.	.48[g]	100[i]
1975-1985	-2.8	60[b]	.59[h]	72[j]
1985-1991	-1.6	69.7[c]	.59 [c]	44[k]
1991-1995	-4.4	73.8[d]	.66 [d]	21[l]
1995-1998	.12	69.2[e]	.61[e]	
1998-2000	.56	73[f]	.66[f]	

Note: a. Gini's refer to income distributions. b. 1974-75 (World Bank 1994); c.1991; d. 1993; e. 1996; f. 1998; g. 1959 (World Bank 1994); h. 1974-75 (World Bank 1994); i. 1970 (World Bank 1994); j. 1980 (World Bank 1994); k. 1986 (World Bank 1994); 1992 (World Bank 1994).

Table 7 shows growth per capita, poverty incidence, Ginis, and real wage data over the post-indendence period. Since the mid-1970s Zambia has experienced a secular decline in GDP per capita growth and in the real wage, while poverty incidence and inequality have increased. The data suggest that the greater the decrease in per capita GDP, the greater the increase in poverty incidence. The increase in inequality has presumably worked in the same direction and may be responsible for the fact that although there has been some growth in the last few years, poverty has not fallen. It should also be noted that, if the recent data on distribution are reasonably accurate, then Zambia has one of the highest levels of inequality in the world.

Identifying the Poor

For policy purposes, it is important to identify those groups that are disproportionately poor. The identity of the poor will vary depending on what measure of poverty is used. In this section we concentrate on poverty as defined by money-metric measures. Table 8 shows that while the incidence of poverty for small farmers decreased between 1991 and 1998, this group still had the highest incidence of poverty among the different socioeconomic strata.[24]

In addition, the depth of poverty is higher among small farmers than among any other group. By contrast, the incidence of poverty among the rural non-agricultural stratum and the strata living in the urban low and medium cost areas has been *increasing*. Between 1991 and 1998 the incidence of poverty among the rural non-agricultural stratum increased by over 12 percent, while poverty in urban low cost and medium cost areas increased by 10 percent and over 20 percent, respectively. In addition to the increasing trend in poverty incidence experienced by the rural non-agricultural stratum, the depth of poverty of this group is among the highest.

[24] While Table 8 shows that poverty incidence and depth decreased dramatically among large-scale farmers, these estimates should be interpreted with some caution because this group constitutes only a small proportion of total farmers. Zambia has approximately 600 to 750 large-scale commercial farmers who cultivate over 50 hectares and possess extensive mechanization. There are 400, 00 to 60,000 emergent farmers who cultivate between 5 and 20 hectares and use purchased inputs and 800,000 households that cultivate an average of 1.45 hectares of land, using low-input technology (World Bank 2003).

Table 8: Incidence and Depth of Poverty by Socioeconomic Stratum (Percent and Percent Change), 1991-1998

	1991	1993	1996	1998	%Change 1991-1998	Depth of Poverty 1991	Depth of Poverty 1998	%Change 1991-1998
Stratum								
Small scale farmers	90	92.4	84	84	-6	70.8	56.2	-14.6
Medium size farmers	78.5	90.8	65	72	-6.5	62.1	48.2	-13.9
Large scale farmers	61.6	n.a.	35	17	-44.6	51.3	26.9	-24.4
Rural non-agricultural	70.4	n.a.	72	79	8.6	59.0	51.1	-7.9
Urban low cost areas	55.5	50.2	51	61	5.5	46.9	38.9	-8
Urban medium cost areas	42.6	40.9	32	51	8.4	46.3	32.1	-14.2
Urban high cost areas	36.1	33	24	34	-2.1	44.1	30.7	-13.4

Source: CSO. 1991; CSO. 1993; CSO. 1996; CSO. 1998; CSO. 1997.

Female-headed households (both married and widowed) represent another of the poorest groups in Zambia. Not only the incidence of poverty, but the incidence of extreme poverty and the depth and severity of poverty were higher for female-headed households than for male-headed households (see Table 9). Compounding this problem is the fact that the proportion of the population living in households headed by widows increased from 4.8 percent in 1991 to 7.4 percent in 1996 and the proportion of female-headed households in general increased from 20 percent in 1991 to 24 percent in 1996.

Table 9: Incidence of Poverty by Head of Household Gender

	1991	1993	1996	1998
Poverty Incidence				
Female headed	76.9	81.1	73.2	77
Male headed	68.4	72.5	68.2	72
Extreme Poverty				
Female headed	67.6	70.5	60.4	65
Male headed	56.5	58.7	51.5	56

Source: CSO.1997; CSO. 1998.

Seasonal Character of Poverty

In the Zambian context, another critical dimension of poverty that policymakers must consider is its seasonal character, especially in rural areas. The months of January through March are referred to as the "hungry season" in Zambia, because these months fall between the harvesting and planting seasons. Resources are scarce because they have been expended in planting and it is too early for rain-fed crops to produce output. In addition, during this season there is no bush or forest fruit available. Consequently, this is the period in which rural Zambians must draw upon

Table 10: Non-Income Measures of Poverty, 1990-2001

	1980	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
HEALTH													
Mortality rate, infant (per 1,000 live births)	92	107.3	..	108.0	..	109.0	110.3	..	113.0	..	114.0	112	112
Under 5 mortality rate (per 1,000 live births)	197	…	..	194[a]	..	..	..	198[b]	..	202	..	202	202
Maternal mortality ratio (per 100,000 live births)	..	..	..	..	..	..	..	649	..	..	..	..	729
Stunted children	..	…	..	..	..	..	..	46	..	..	..	..	47
Immunization, (% of children under 12 months)	..	71.0	91.0	61.0	67.0	86.0	82.0	83.0	70.0	..	92.0	..	..
Life expectancy at birth, total (years)	50.5	49.1	..	48.8	..	..	45.4	..	43.1	..	38.5	38	37
HIV/AIDS prevalence rate	..	..	..	..	..	20	..	18.5	..	..	..	..	19[c]
KNOWLEDGE													
Illiteracy rate, adult total (% of people 15+)	..	31.9	30.8	29.7	28.7	27.7	26.8	25.7	24.7	23.7	22.8	21.9	..
School enrollment, primary (% gross)	89.9	98.7	99.0	100.2	..	90.8	88.5	..	..	..	..	..	..
Primary age attendance	..	..	..	..	..	..	..	69	..	68	..	..	..
Female primary attendance	..	..	..	..	..	..	..	70	..	68	..	..	..
STANDARD OF LIVING													
Sanitation (% of population with access)	..	63.0	..	..	..	..	..	..	..	..	..	78.0	..
Population not using improved water sources (%)	..	10.5	..	..	..	..	..	..	..	..	36	..	36
Total orphans as % of all children (ages 0-14)	..	..	..	..	..	..	13.8	..	..	..	..	..	17.6

Source: UNDP. 2002; World Bank. *World Development Indicators, Cd-Rom; SIMA and Region Database,* Various years; CSO. 1997; CSO. 2003; Zambia, Central Board of Health (CBOH). 2002; The Synergy Project. 2002;
a. Between 1989-1992
b. Between 1994-1996
Note: There is some disagreement over the 2001-2002 HIV/AIDS prevalence estimates. The *Zambia Demographic Health Survey 2001-2002* (DHS) estimates a 16 percent prevalence rate for the adult population age 15-49, while the 2001-2002 Zambia Antenatal Care (ANC) (2002) sentinel surveillance data estimates 19 percent for the same population.

any reserves they may have to carry them through to either the harvesting period, which begins in the month of May or, if they are fortunate they may be able to pre-sell a portion of their crop in April. Warehouse receipt programs have proven to be sound mechanisms for improving farmers liquidity (USAID/Zambia 2003). The development of such programs throughout Zambia may be an important technique that not only smoothes farmers' consumption in the "hungry seasons", but also provides them with the ability to invest and therefore improve productivity, output and income.

Multidimensional Character of Poverty

As noted above, poverty is multidimensional. A number of poverty indicators exist that gauge non-income-related deprivation in such aspects of human welfare as health, education, nutrition, and overall standard of living. Table10 presents some key non-income indicators of poverty. It is clear from Table 10 that the trend in poverty measured by non-money metric indicators mirrors the increasing trend in poverty as measured by income-related indicators. Particularly egregious is the decrease in life expectancy from 49.1 years to 37 years in the span of a little more than a decade. Life expectancy has been declining for at least two decades, but the rate of decline has recently increased. It is reasonable to assume that the decrease in life expectancy is, in part, related to the decrease in per capita GDP and that the high incidence of HIV/AIDS has compounded this problem, leading to the more rapid decline in life expectancy in the 1990s. Additionally, the increase in both infant and child mortality is an indicator of the declining quality of pre-natal and pediatric health services. The percentage of children (aged 3 to 39 months) that are stunted is extremely high relative to other developing countries. Clearly, this points to chronic malnutrition among children. Stunted children are likely to suffer from impaired cognitive functions, be physically weaker, and have an impaired immune system. Unfortunately, the incidence of stunting increased between 1996 and 1998. This is likely directly related to the increasing poverty levels, the lack of food security, and the increasing dependence ratios. The fact that over 50 percent of Zambian children are stunted and more than 17 percent are orphans does not bode well for Zambia's future. Given these indicators it is hardly surprising that Zambia is the only country to have a worse ranking on UNDP's Human Development Indicators in 2002 than in 1975.

Summary of Poverty Profile

The incidence of poverty in Zambia increased by 3.3 percent between 1991 and 1998 (see Table 4). This is striking given the already high level of poverty that existed. While overall poverty depth and severity have decreased during the same period, they are still high relative to other developing countries. Statistics show significant geographical variation with rural areas exhibiting worse conditions (this is especially true in the remote districts of remote provinces) than urban centers. However, it is interesting to note that over the last decade poverty has been decreasing in rural areas (among small, medium, and large farmers) and increasing in urban areas. Poverty, which afflicts the overwhelming majority of Zambians, manifests and sustains itself in various ways, including chronic malnutrition, insufficient access to basic social services and necessities such as education, health and clean water. All of these indicators show a worsening trend during the 1990s.

CHAPTER FIVE
EXPLAINING PATTERNS OF GROWTH AND POVERTY REDUCTION IN ZAMBIA, 1990-2000

Zambia's economic performance during the 1990s was dismal: on average, real GDP per capita decreased nearly 2 percent per year and the poverty headcount increased by over 3 percent between 1991 and 1998 (see Tables 2 and 4). Most studies that examine Zambia's economic performance in the 1990s focus solely on its (admittedly poor) average performance over the decade. However, it is interesting to look beyond the decanal average growth rate and to disaggregate it both by sub-period and by activity. What emerges is a clear downward trend in real GDP per capita between 1990 and 1995 (4.1 percent decrease per annum), a slight positive trend between 1995 and 2000 (.30 percent increase per annum) and a continuing upward growth trend since 1998 (see Table 11).[25] These indicators beg the following questions: what factors contributed to Zambia's particularly poor economic performance in the first half of the 1990s and the associated increase in poverty? What explains the apparent turnaround evidenced by the mildly increasing GDP per capita in the latter half of the 1990s? In particular, what role, if any, has policy reform played in bringing about the better performance? Is the positive growth trend of the last few years sustainable?

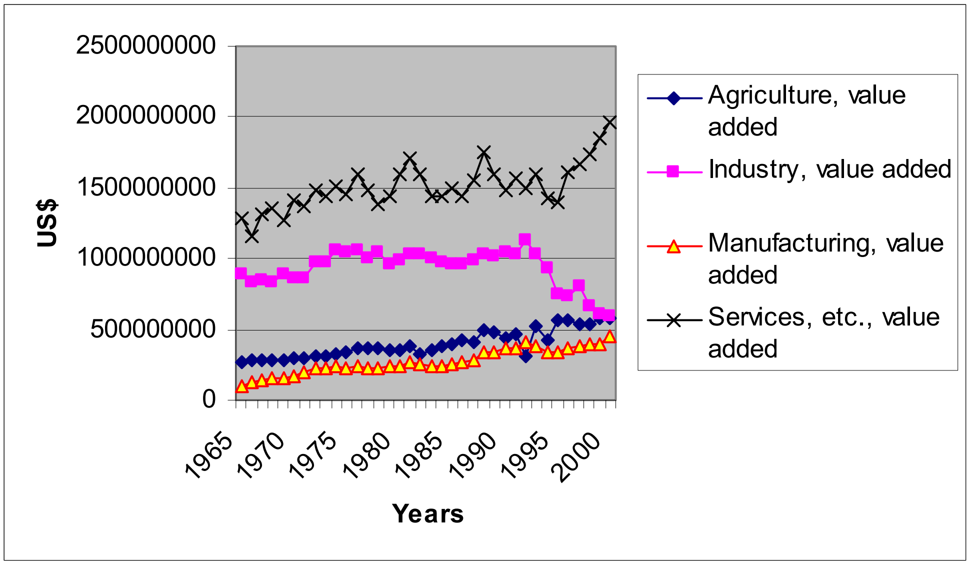
LOOKING BEYOND THE DECANAL AVERAGE: DISAGGREGATING THE GROWTH AND POVERTY TRENDS BY SUB-PERIOD AND SECTOR

Numerous factors contributed to Zambia's poor average economic performance in the 1990s, including declining copper prices, a series of devastating droughts between 1992 and 2002, and Zambia's extraordinarily high debt servicing costs.[26] Figure 6 shows that with the exception of the industrial sector (of which mining is a significant part) that contracted by close to 6 percent, the other broad sectors of the Zambian economy grew during the 1990s. But their average annual growth during the first half of the 1990s was insufficient to compensate for the decline in the dominant mining sector. Indeed, by 1995 ores and metals exports still accounted for 86.5 percent of total merchandise exports, while manufacturing, fuel, agriculture, and food exports accounted for a mere 7, 3.25, .56, and 2.7 percent of the total, respectively (World Bank 2002). The mining industry thus continued to be the dominant foreign exchange earner and contributor to government revenues in Zambia despite the severity of its contraction. Nonetheless, GDP growth in the second half of the 1990s can be attributed, in part, to growth in the non-mining sector (services, in particular), which was growing at the reasonably impressive rate of 5.5 percent. We will now turn to an examination of underlying sectoral growth to determine how it contributed to the patterns of growth and poverty in the 1990s.

[25] It appears that this positive growth trend continued to 2002 despite the drought. Indeed, growth in 2002 was estimated to be close to 3 percent (EIU 2003). Assuming population growth remained at 2 percent, GDP per capita then grew by 1 percent in 2002. Unfortunately, the latest poverty estimate that exists is for 1998. It is therefore not possible to determine what happened to poverty during the last part of the decade when GDP per capita has been increasing.

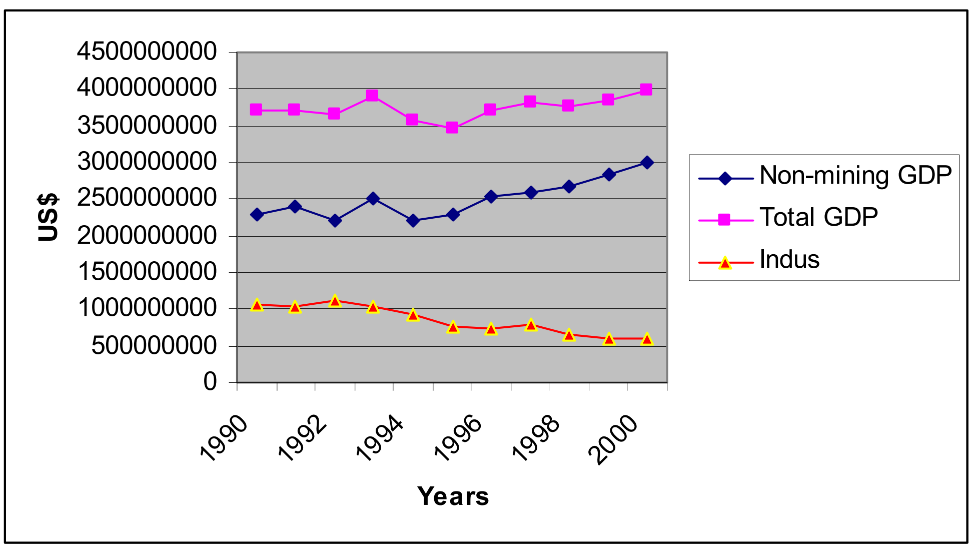
[26] Admittedly, the mining sector's continuing depressing effect on GDP growth possibly makes the indicator a harsh criterion of economic performance.

Figure 6: Sectoral Value Added (constant 1995 US$), 1965-2000



Source: World Bank. *World Development Indicators, Cd-Rom.*
Note: Data for "Industry" was calculated by the author and includes mining, construction, electricity, gas, and water. This definition of industry is used throughout this paper.

Figure 7: Comparison of Non-Mining real GDP and real GDP (constant 1995 US$), 1990-2000



Source: World Bank. *World Development Indictors, Cd-Rom.*

Table 11: Sectoral Value Added, real GDP, real Non-Mining GDP and real per capita GDP (average annual rate of growth) (constant 1995 US$), 1965-2000

	1965-1980	1980-1990	1990-1995	1995-2000	1990-2000
Agriculture	1.6	2.4	5.1	0.7	3.94
Industry	.50	.57	-6.5	-4.6	-5.6
Manufacturing	5.9	4.3	-1.3	5.7	2.1
Services	1.5	-0.8	-1.1	7.1	2.9
Real Non-mining GDP[a]	1.7	.5	.1	5.5	2.8
Real GDP	1.4	1.04	-1.4	2.69	.62
Real GDP per capita	-1.66	-1.99	-4.13	.3	-1.94

Source: Author's calcluation. Calculated on the basis of World Bank. *World Development Indicators,* Cd-Rom.
Note: The category "industry" is composed of mining, construction, electricity, gas and water.
Non-mining GDP was calculated by adding the value added of agriculture, manufacturing and services. It excludes industry, which while broader than mining alone, is largely composed of mining activities.

Agriculture

Table 11 shows that on average, growth of value added in agriculture was healthy during the 1990s, increasing at an annual average of almost 4 percent. This represents a substantial increase over the level of growth in the pre-reform period and is consistent with the decrease in rural poverty over the 1990s. Not surprisingly, agricultural growth and rural poverty (incidence, depth, and severity) appear to be negatively correlated: rural poverty decreases when agricultural value added increased in the first half of the 1990s and the opposite occurred in the last half of the 1990s.

The growth exhibited by this sector, especially in the first half of the 1990s, may be partially related to the success of *elements* of economic reform, such as the elimination of pan-territorial maize pricing which has encouraged some crop diversity. However, while average agricultural growth over the decade was strong, it was also volatile. Virtually all of it occurred in the first half of the 1990s, which corresponds to the transition period to more market-oriented agriculture (World Bank 2003). The bumper crop of 1993 is, in part, responsible for pulling up the average annual production and value added in the early part of the 1990s.

Bad weather conditions contributed to the decline in agricultural growth over the last half of the 1990s.[27] In addition, demand side factors, some of which resulted from elements of the economic reform program, contributed to declining agricultural growth in the late 1990s. These include decreasing prices for agricultural crops in international markets and increased competition from a broad range of imported agricultural products due to trade liberalization. On the supply side, periodic policy changes with regard to commodity markets and the fertilizer market (causing fertilizer shortages) and liquidity problems (as a result of exorbitantly high interest rates) reduced farmers' ability to purchase inputs and replace farm equipment (World Bank 2003).

[27] Zambia experienced droughts in 1992, 1995, 1997, 1998, 2001, and 2002. Given the predominance of rain-fed crops in Zambian agriculture, the sector is especially vulnerable to rainfall patterns.

Manufacturing

Manufacturing exhibited a less encouraging level of value added growth during the 1990s, averaging 2.1 percent annual growth, which is significantly lower than pre-liberalization growth rates (see Table 11). Prior to economic reform, industrial policy consisted of "state control of ownership and management of industry by the state; government direction of investment, including that in the private sector; and protection of domestic industry from foreign competition" (World Bank 1994). Government policies distorted incentives in the manufacturing sector and resulted in an inefficient sector that was unable to compete in domestic or export markets without protection. Further, policies such as the overvalued Kwacha and low tariffs on capital goods encouraged import dependence and capital-intensive production, rather than labor-intensive production. As a result, the manufacturing sector in this labor surplus country generated relatively few employment opportunities.

Figure 7 shows that in the first half of the 1990s, manufacturing experienced a downturn, which is not surprising given that it was faced with a simultaneous shock of trade liberalization and the loss of subsidized credit (McCulloch et al. 2003). Additionally, this sector faced declining domestic demand as GDP per capita fell and high fuel (due to high tax structure on this commodity), transport, and electricity costs and higher costs of imported inputs due to a liberalized foreign exchange regime that early resulted in a depreciated Kwacha in the early 1990s (World Bank 1994). The textile industry, which nearly collapsed, was hit particularly hard by these reforms (McCulloch et al. 2003).

Much of the decline in formal sector employment demand in the 1990s has come as a result of declining performance in the manufacturing and mining sectors (McCulloch et al. 2003). The manufacturing sector experienced an employment decline from 75,400 workers in 1991 to 43,320 in 1998 (McCulloch et al. 2003). Indeed, over the 1990s the textile industry, which was composed of more than 140 manufacturing firms and employed 34,000 workers, was whittled down to fewer than eight firms and approximately 4,000 jobs (Jeter 2002). The loss of employment in the manufacturing sector as a whole has pushed countless numbers into poverty, thereby pushing up the level of urban poverty. It has also swelled the ranks of the informal sector where people work in below-poverty forms of petty self employment.

Nearly two-thirds of manufacturing is in the food, beverages, and tobacco sub-sector (EIU 2002).[28] By the last half of the 1990s many of the SOEs in this sub-sector had been privatized. Few new industries have emerged over the last decade and indeed some of Zambia's major companies have closed shop, citing high fixed costs, weak domestic demand, and their inability to compete regionally (EIU 2002). Growth in the last half of the decade has thus come from increased efficiency of existing firms as a result of privatization and policy changes. The World Bank (2003) reports that "In the wake of policy reforms and privatizations there occurred a considerable level of investment in agro-processing and food distribution, whether to refurbish existing capacity (i.e., in cotton ginning, dairy processing, beer brewing , retail distribution) or to expand available processing capacity (i.e., wheat milling, poultry processing)" (94). A large

[28] Indeed, much of the growth in manufacturing in the latter half of the 1990s is attributed to maize milling, which is classified as a manufacturing activity.

share of the investment came from inflows of foreign direct investment (FDI).[29] Zambia continues to struggle to compete with other countries in the region as a manufacturing base (EIU 1997). The aforementioned obstacles to the growth continue to plague the sector and must be overcome for this sector to contribute to overall growth and poverty reduction through labor-intensive employment creation.

Services

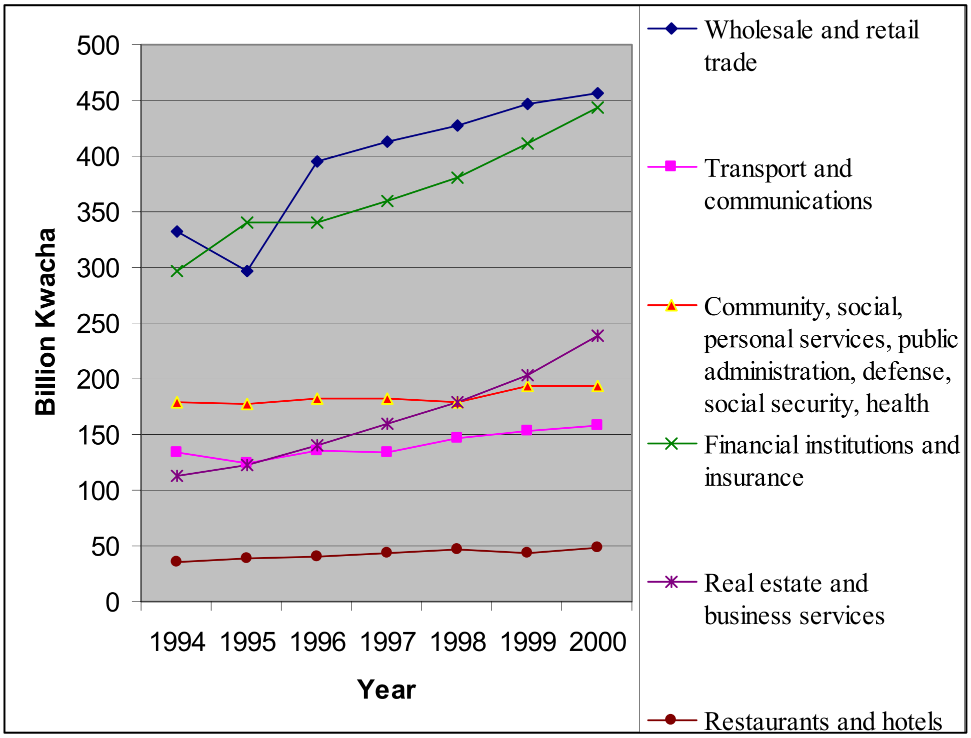
Although the annual average value added growth rate for the service sector in the 1990s was 2.9 percent, between 1995 and 2000, it averaged extraordinary growth rates of 7.1 per year (see Table 11). This level of growth is significant given the relative importance of the service sector in the Zambian economy.[30] Figure 8 suggests that growth in the service sector appears to have driven GDP growth in the latter half of the 1990s. More specifically, it shows that growth in the service sector has been driven by growth of three sub-sectors: financial institutions and insurance; wholesale and retail trade; and real estate and business services. It is important to disaggregate the data to determine what aspects of growth in the service sector contributed to GDP growth in the 1990s and whether it is sustainable.

Figure 8 shows that growth in the service sector has been driven by growth of three sub-sectors: financial institutions and insurance; wholesale retail and trade; and real estate and business services. Financial sector reforms in the early 1990s resulted in the development of new forms and types of financial institutions, including non-bank financial institutions (NBFIs) such as leasing companies, building societies, deposit taking NBFIs, and development financial institutions (Maimbo 2003). In addition, there was a significant increase in the number of banks in the early part of the decade and microfinance institutions in the latter part of the decade. While a series of local bank failures provoked loss of confidence in local banks, it is reasonable to assume that despite these events the financial deepening that occurred over the decade resulted in the sub-sector's high level of growth over the 1990s.

The wholesale and retail trade sub-sector includes both formal and informal trade. The most significant development in formal sector retail and wholesale trade in Zambia has been the arrival of the "supermarket revolution" in the mid-1990s. As a result of privatization, Shoprite Checkers, South Africa's largest food/grocery retailer acquired the previously state-owned food and grocery retail outlets.[31] Until Shoprite's arrival the system of food and grocery distribution in urban areas was highly fragmented and included state-owned retail stores and family owned medium-size specialty stores. By 2001, Shoprite had established a network of 17 retail stores and one wholesale outlet, reaching virtually all of Zambia's major town and thus a high proportion of Zambia's consumer's of packaged food and grocery products. "Its initial growth was also

[29] Gross domestic investment increased by 15 percent over the same period, reaching 18.3 percent of GDP in 2000 (see Table 2). This level is just enough to maintain existing capital stock. On the other hand, it is estimated that investment levels of 30 percent are needed to stimulate improved growth levels.
[30] The service sector's contribution to GDP averaged over 40 percent in the 1990s as compared to industry, which contributed 38 percent and agriculture and manufacturing, which contributed just over 20 percent each.
[31] This paragraph draws heavily from World Bank (2003).

Figure 8: Disaggregation of Service Sector Value Added, 1994-2000 (constant 1995 Kwacha)*



Source: United Nations. 2002; IMF. 2003 (unpublished data). Author's calculations.
*Note: Data for the years 1989-1991 are derived from UN (2002).

facilitated by considerable pent up demand, due to the limited consumer choice previously of food and grocery items" (World Bank 2003: 102). Shoprite's share of the Lusaka consumer market is currently estimated to be 50 percent and is considerably higher elsewhere. The supermarket revolution was initially expected to have a positive impact on Zambian food processing and agriculture, stimulating increased demand for the sub-sector's products. However, actual experience has been different. Shoprite has largely relied on imported goods to supply their outlets, in part, because it is not able to locally source products in the volumes, at the quality levels, and/or competitive price it requires.

Informal sector trade has been growing at an average of 6 percent per year in the last half of the 1990s (EIU 2002). As employment opportunities in the formal sector have dried up people have been forced to find a source of income in the growing informal sector. It is estimated that the informal sector absorbs more than 70 percent of the Zambian labor force (World Bank 2002). While informal sector employment may provide a cushion for poor families and thus help bring them closer to the poverty line, it is an unstable source of income and is rarely sufficient to pull the poor out of poverty. Furthermore, a growing informal sector does not bode well for a government's fiscal health and its ability to provide basic social services and badly needed social safety nets to its most vulnerable citizens. Growth in the informal sector, absent healthy growth in the formal sector, is a sign of a fundamentally weak economy.

Developments in the real estate market over the 1990s have been interesting. Maimbo (2003) reports growth in private property investment starting in the latter half of the 1990s as a result of the privatization of state enterprises and the central and local government divestment from providing public housing and the loss of confidence in local banks as a result of a series of bank collapses. The latter resulted in capital flight from local banks to foreign banks (which were perceived as being better managed and more stable) and to non-financial assets such as real estate (ibid). The recent Land Law of 1995, which facilitated the creation of a land market in Zambia, also encouraged investment in real estate. Indeed, property value in Lusaka has been rising at an annual rate of 30 percent, while the value of urban land for development has been increasing at a rate of 70 percent per year (Chikolwa 1996 in Maimbo 2003).

Tourism, while particularly vulnerable to global forces, is an underdeveloped sector in Zambia which is promoted by the PRSP as having the potential to contribute to pro-poor growth. Zambia possesses considerable untapped natural resources for tourism and ecotourism development, including abundant wildlife, rich cultural and natural heritage sites, and abundant water resources. Indeed, recent investments in this sector have been encouraging, resulting in more than 24 percent growth in the sector in 2002 (EIU 2002). The PRSP also promotes other non-mining sectors as potential sources of pro-poor growth such as the agricultural sector (agricultural exports, in particular), and manufacturing sector (processing of agricultural and forestry products).

In sum, during the early 1990s, the overvaluation, high interest rates, and disarray in agricultural policy contributed to the stagnation in the non-mining sector. By the last half of the 1990s, the most pernicious of these effects were over and some of the benefits of stabilization and adjustment may have contributed to the decent growth that occurred. This growth has been driven by growth in the service sector. The growth in financial services may indicate that this sector is poised to continue its advance. However, the strong reported growth in the other non-tradable sub-sectors such as retail and informal sector trade, whose demand is closely tied to overall GDP growth, cannot be counted on as a continuing source of atypically fast expansion. In order to achieve sustainable pro-poor growth the government will have to promote the further diversification of the formal economy and therefore the development of stable employment-creating sectors from which it can derive revenue.

EXAMINING THE IMPACT OF POLICY REFORM ON GROWTH AND POVERTY IN ZAMBIA

The previous sub-section examined the sectoral pattern of growth to determine how it contributed to overall economic performance in Zambia in the 1990s. By contrast, this sub-section examines the extent to which policies, and more specifically the implementation of the SAP, influenced those patterns and through them the overall growth and poverty trends in Zambia.[32]

[32] The discussion of the pattern will be limited to the 1991 to 1998 period because the poverty estimates for 1998 represent the most recent available estimates.

The lack of significant diversification of the economy after almost three decades of decline in the mining sector's contribution to the Zambian economy is both a direct cause of the country's weak economic performance and an indicator of poor economic management. Various aspects of the implementation of economic reform emerge as key to explaining why it did not produce vigorous and stable growth and poverty reduction in the 1990s; prominent among these are unevenness of implementation; the lack of policy coordination and the related problems with the sequencing of reforms; and waning government commitment to reform as well as increasing government corruption.

Implementing SAP

Upon assuming power, the Chiluba government was faced with a collapsing Zambian economy plagued by hyperinflation. It responded by undertaking a conventional SAP in 1991. At the outset, it was committed to the reforms and pursued them aggressively. Both its 1991 manifesto and its Policy Framework Paper highlighted the government's three economic goals: 1) restoring macroeconomic stability; 2) promoting the private sector's role as the engine of economic growth by reducing the level of state intervention in the economy; and 3) transforming the industrial sector and agricultural marketing and input supply from a system of public monopolies to one of private and decentralized institutions (Rakner et al. 2001: 556). The assumption underlying these goals was that their achievement would provide the appropriate incentives to which the private sector would respond, and that vigorous growth of agriculture and manufacturing would ensue.

The government's ability to aggressively pursue economic reform was facilitated by at least three factors: first, the landslide elections gave the Chiluba government the mandate needed to tackle economic reform. Second, a highly qualified cabinet of technocrats who were relatively insulated from patronage politics and committed to economic and political reform was appointed. Their relative insulation from patronage politics was exceptional given that Zambia's politics is traditionally based on patronage (Duncan et al. 2003). Third, donors rewarded Zambia with significantly increased levels of official development assistance for taking on dual reforms of democratization and liberalization (Rakner et al. 2001).[33]

Uneven Implementation of Reforms: Stabilization and Privatization

As part of the SAP, the Chiluba government initiated a macroeconomic stabilization package to control inflation, restore fiscal balance and pave the way for a return to growth. The macroeconomic reforms focused on monetary and fiscal reforms. Early on, subsidies on mealie meal were cut, the exchange rate and commercial banking rates liberalized, a cash budgeting system introduced, the reserve ratio increased, an active issue of Treasury bills initiated, and the semi-autonomous Zambia Revenue Authority created.

[33] Between 1990 and 1991, donors almost doubled ODA, increasing it from approximately US$480 million to US$ 883 million (OECD).

The government also began implementing structural reforms directed at both external and internal liberalization such as trade and financial market liberalization, and agricultural marketing reform (see Appendix A for list of reforms undertaken between 1991 and 1994). In addition, the government announced its commitment to privatization in 1991 (although real progress on privatization was not made until 1995) and in 1993, it announced reforms focused on institutional restructuring, namely, public sector reform.

The stabilization measures helped to reduce inflation from a high of nearly 200 percent to approximately 30 percent in two years (see Table 2). However, an unwelcome and unexpected outcome of the stabilization policies was a significant increase in real interest rates such that by 1994 they exceeded 100 percent. This combined with the release of official foreign exchange led to a real appreciation of the Kwacha. The appreciation (which pushed down the price of tradables) and the simultaneous credit squeeze acted as a disincentive to private sector investment. As a private sector supply response was critical to the success of Zambia's growth strategy, these outcomes jeopardized its realization (World Bank 1994).

Impact of Stabilization Measures on the Urban Poor

The stabilization measures had an especially negative impact on the urban poor as is evidenced by the increasing rates of urban poverty (see Table 4). The rising prices from the elimination of maize subsidies and the liberalization of the exchange rate, which resulted in increased prices of traded goods, increased the cost of living for urban residents. Widespread redundancies from privatized firms led many urban workers to seek employment in the informal sector. Additionally, Dinh et al. (2002) found that the cash budgeting system "had a deeply pernicious effect on the quality of service delivery to the poor". In particular, it redirected resources away from ministries and agencies charged with providing social and economic services, contributing to increased poverty of urban poor who tended to have better access to and thus rely more on these services. In addition, the inherent lack of predictability as to what funding levels will be have made it difficult for ministries to accurately plan, resulting in compromised service delivery or service delivery that is destabilized. Often ministries are forced to "engage in unproductive activity or obtain resources on credit, thereby accumulating arrears (Dinh et al. 2002: 30).

Though the government moved to quickly implement stabilization measures and financial and trade reform, key aspects of structural adjustment, including public sector reform and privatization of the copper industry were delayed. The failure of the government to reform the public sector and its having delayed the privatization of the copper industry proved to be a significant obstacle to economic growth.

The government announced in its 1991 manifesto that it was committed to privatization. However, unlike the "shock therapy" approach to stabilization and other areas such as agricultural reform, the implementation pattern of the privatization process was very slow and only picked up steam in 1995 (Rakner et al. 2001). Public sector enterprises accounted for 80 percent of GDP in 1991 and employed 140,000 workers, making privatization a politically contentious endeavor (ibid.).[34] The government's cautious approach involved privatizing the smaller companies first.[35] By 1997, 82 percent of the companies slated to be sold had indeed been privatized, allowing the government to allege that the process was a success by focusing on the number of firms privatized rather than their importance to the Zambian economy. Given the dominance of copper and the continuing decline in copper price, the need to privatize the sector became more urgent.

The government's delay in privatizing the copper mining sector resulted in continued poor performance of that sector and thus compromised the potential for economic recovery (ibid.). Throughout the 1990s, the mines remained a huge drain on public coffers. In addition, they did not receive badly needed investment, resulting in declining quality, production levels, and revenue. After bungling an opportunity to sell Zambia Consolidated Copper Mines (ZCCM) at what was considered to be a fair market price in 1997, the government finally privatized ZCCM. It was sold to Anglo American in March 2000 with the government realizing far less for these assets than had originally been offered (EIU 2002).[36] Following privatization, copper production levels began to increase because of new investments made in the mines.

The way in which the Chiluba government quickly implemented stabilization yet bungled the privatization process is illustrative of the uneven implementation of reforms in Zambia and the fact that reforms did not respond to changing external environment (e.g., falling copper prices). The mining sector continued to generate returns below its potential all the while diverting public resources from potentially more productive areas.

Problems with Policy Coordination

Agricultural sector reforms

Implementation of economic reforms in Zambia suffered from a lack of overall reform coordination and the related problems with sequencing of reforms. The maize market liberalization of 1993 provides an excellent example of these problems. In 1992, the government eliminated pan-territorial pricing for maize and liberalized maize imports and consumer prices. A drought that same year put further liberalization of agriculture on hold until the following year. In 1993, the government abandoned market principles and appointed a number of principal buying agents, which were government-supported agricultural lending institutions. It provided

[34] Many analysts feared that labor unions would strongly oppose and thus threaten the implementation of privatization. Interestingly, however, Chiluba leveraged the legitimacy gained from nine years as President of the Zambian Confederation of Trade Unions (ZCTU) as well as his friendship with the sitting ZCTU President to convince the unions that they would reap benefits of privatization and liberalization in the medium-to long-term if they desisted in their protests and further tightened their belts in the short term. Chiluba also moved to weaken the unions by severing the ties between the most powerful unions (i.e., mines, financial, and the civil service) and the ZCTU.

[35] One of the complaints about the privatization process was that it was not transparent, resulting in many state-owned enterprises going to government ministers and politically-connected individuals.

[36] In 2002, Anglo American decided to withdraw from Zambia, leaving a great deal of uncertainty about the future of the copper sector in Zambia.

them with 15 billion Kwacha with which to purchase maize at a predetermined floor price. It was expected that private traders would enter the market and purchase whatever maize remained. For a variety of reasons, including hyperinflation of 188 percent; exorbitantly high interest rates on the newly introduced Treasury bills; the excessively high government-established floor price for maize; and the unpredictability of government activities in the maize market, these traders did not respond to the opportunity. The majority of private traders as well as some principal buying agents therefore invested in low-risk Treasury bills rather than maize (World Bank 1994).[37]

In addition to failing to realize the goal of liberalizing the agricultural sector, a large portion of the credit provided to the principal buying agents was never recovered (Wichern et al. 1999). By the end of the 1992/3 season, principal buying agents owed farmers 22 billion Kwacha (ibid.). The government was thus forced to enter into the market to compensate the farmers. However, due to the restrictions of the recently introduced cash budget, the funding came in the form of promissory notes redeemable 6 to 12 months later (World Bank 1994). All of this put a severe strain on the 1994 budget.[38]

The government abolished the minimum price of maize and eliminated the use of private buying agents in 1994. To date, liberalization of the agricultural sector remains incomplete. Indeed, agricultural policies (especially those relating to maize) continue to be poorly designed and characterized by a lack of clarity. Export restrictions in the form of cumbersome licensing requirements and/or export bans make it impossible for traders to take full advantage of regional markets. The government continues to intervene in the fertilizer market, increasing the uncertainty and risk for traders and resulting in an inefficient inputs market: traders have not filled the vacuum left by the government (especially in remote rural areas) and farmers are thus unable to access fertilizer. The overvaluation of the exchange rate also has had major indirect negative effects, leading to a net taxing of producers of export crops. Further complicating matters, there has been a collapse in government expenditure on transport and communications as a result of government belt tightening measures. This has compounded the difficulties already faced by farmers in these areas because it has raised the cost to the private sector of providing credit, inputs, and marketing services to farmers, especially those in remote rural areas,.

Despite these remaining obstacles, farmers of all sizes seem to have fared better since liberalization was initiated. This is due in part to higher international prices in the early part of the 1990s, reform policies that have encouraged crop diversification, and relatively improved market opportunities due to internal market liberalization.

Several lessons can be drawn from Zambia's early experience with maize market liberalization. First, in the absence of overall policy coordination, problems with sequencing of reforms emerged. Indeed, simultaneous financial sector and agricultural sector reforms worked at cross purposes. Second, the uncertain policy environment created by the government's seesawing on the policy of intervening in the agricultural market hampered the desire and ability of the private

[37] Another factor that conditioned the unresponsiveness of traders in the maize market was that in addition to the government's floor price, which distorted the market, traders had to contend with food aid that resulted in a decrease in consumer prices and a further reduction in the profit margin (Wichern et al. 1999).

[38] The Zambian government introduced a cash budgeting system in 1993 in an effort to reduce the budget deficit. Under a cash budgeting system, ministries can only spend money once they have received it.

sector to engage in the agricultural market. Third, the government's assumptions regarding the ability of the private sector to fill the vacuum of the retreating public sector were incorrect, resulting in the vicious circle of government intervention to take up the slack and the private sector retreating further from an unpredictable agricultural market. The Zambian government did not consider the fact that the private sector was relatively small and weak as a result of years of socialist policies, which largely shut them out of the market. Thus, in addition, to the high cost of credit, the incentives to invest in Treasury bonds, and the uncertainty in agricultural (and especially maize markets) because of unpredictable government policies, the expected supply response from the private sector was not sufficiently strong to play the role that was envisioned for private sector actors.

Trade Reforms

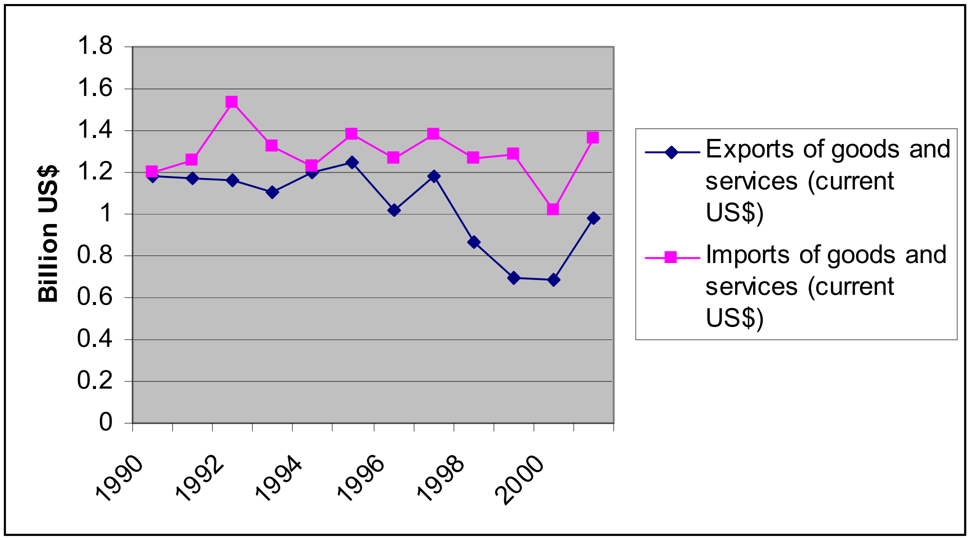
Wide ranging trade reforms were initiated in 1992. Between 1992 and 1997, all licensing and quantitative restrictions on imports and exports were eliminated, tariffs reduced and simplified and the needed documentation greatly simplified (Rakner et al. 2001). In addition, the liberalization of the foreign exchange regime allowed exporters to retain their foreign exchange earnings for the first time. The government provided other incentives for exporters such as a preferential tax rate, whereby the rate for exporting corporations was cut from 30 percent to 15 percent. Further, over the past decade, Zambia entered into various trade agreements including, the COMESA Free Trade Agreement, the Southern African Development Community (SADC) Protocol, the EU Everything But Arms initiative and the U.S. Africa Growth and Opportunity Act (AGOA).[39]

Despite the Zambian government's efforts to liberalize trade, the country's trade balance deteriorated throughout the 1990s largely due to the more than 50 percent decline in the value of copper exports (from $1.06 billion in 1990 to $425 million in 2000). Non-traditional exports, which increased from under $100 million in 1990 to approximately $300 million in 2001, have not been able to offset that loss (World Bank 2003).[40] The increase in non-traditional exports, which reached a peak in 1997 before flattening out, was largely driven by agricultural exports, which experienced high prices in international markets. Agricultural export receipts peaked in 1997 and leveled off after. By contrast, exports of manufactured products have decreased over the decade. The appreciating trend in the real exchange rate since 1993 has compounded the obstacles to Zambia's non-traditional exports achieving competitiveness (see Figure 3). Labor-intensive non-traditional exports have the potential to have a significant positive impact on poverty. However, because there has not been an adequate and sustainable increase in these exports, the potential impact on poverty has not been realized.

[39] In October of 2000, Zambia joined the COMESA Free Trade Agreement. Thereby, completely removing all tariffs to products originating from COMESA members.

[40] The term non-traditional exports refers to all goods and services other than copper and cobalt (World Bank 2003).

Figure 9: Trends in Exports and Imports, 1990-2001



Source: World Bank. World Development Indicators, CD-Rom.

Zambia's balance of trade with its regional trading partners has deteriorated since 1990, making it a loser in the region (IMF 2001). Zambia's major markets for non-traditional exports in the region include South Africa, Democratic Republic of Congo (DRC), Congo Malawi, and Zimbabwe. South Africa represents Zambia's largest market for non-traditional exports, followed by the DRC. Zambia has a large and growing trade deficit with South Africa. Zambian exporters have complained that a contributing factor to Zambia's poor export performance and the worsening trade balance is the lack of a level playing field. They claim that their regional trading partners have not been complying with the negotiated trade agreements, while Zambia has, in good faith, honored these trade agreements. The Zambian market, it is claimed, is thus more open than those of its trading partners. When Zambia's increased openness is combined with the appreciating trend in the real exchange rate since 1992, the result is a strong negative impact on its trade balance. Zambia's experience calls into question the wisdom of failing to maintain some level of protection in the context of an appreciating and relatively volatile exchange rate and trading partners that may not be complying with negotiated trade agreements.[41]

The potential benefits from trade liberalization and accompanying incentives have been neutralized by other policies and by external events. For example, the appreciation of the Kwacha vis-à-vis the Rand has presented a major obstacle to Zambians exporting to South Africa (World Bank 2003). Trade with the DRC has been problematic because of instability of that country (ibid.). Continuing inflation, the credit squeeze, high transport costs, and the unpredictable exchange rate for the Kwacha has further hurt Zambia's competitiveness. In addition, "some stakeholders in Zambia…regard as an 'external shock' the rapid and deep opening of the Zambian market to external competitors under the COMESA Free-Trade

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[41] There is some evidence that the Zambian government in reaction to the absence of a level regional playing field has recently moved to increase non-tariff barriers on a number of import-competing goods.

Agreement and other trade agreements in the face of very limited capacity within the Zambian public sector or private sector to adjust and to apply the new set of rules for regional trade" (World Bank 2003: 4).

While Zambia's trade reform did not result in significantly increased exports, an interesting outcome was that the value of imports increased, fueling significant internal trade as is evidenced by the rise in wholesale and retail trade in the 1990s (see Figure 8). The opening of the Zambian market resulted in the entrance (in the mid-late 1990s) of retail stores and supermarkets from South Africa, bringing with them an influx of imports of processed food products from South Africa (and more recently from Zimbabwe) able to meet the quality standards, with deleterious effects for competing Zambian products, providers of retailing and wholesaling services (World Bank 2003). Interestingly, a significant portion of imports and subsequent internal trade has been taken up by the informal sector. A substantial informal sector has emerged that has connections throughout the region and is involved in a booming cross-border trade as well as a domestic petty trading. Indeed, a COMESA-SADC cross-borders traders' association, which is composed of informal traders, has recently emerged. As a result, a large number of jobs have been generated in the informal trading sector in Zambia.[42] This has had a positive impact on the poor. Because this is informal sector petty trading it is not a stable form of income and its impact is not large enough to pull the poor out of poverty. But it may help explain decreasing poverty severity and depth in the urban poor over the 1990s.

Waning Government Commitment to Reform and Increasing Corruption

It appears that the Zambian government's original commitment to economic reform and good governance waned beginning with Chiluba's first electoral term. Early on, the government demonstrated a commitment to stabilization and most aspects of structural adjustment with its implementation measures such as the cash budget, liberalization of the exchange rate, agricultural liberalization, and trade and financial sector reform. As previously discussed, hyperinflation was arrested by 1993, but a stabilization of real per capita GDP did not occur until the mid-1990s. Thus, while the reform-minded ministers might have initiated many of the reforms, whatever fruits they might have yielded were not felt until the mid-1990s.

The 1993 cabinet reshuffle represents a watershed event, with Chiluba beginning to shed some of the more competent and reform-minded ministers and to replace them with younger, inexperienced ministers who were loyal to him, politically driven and thus more prone to corruption (Rakner et al. 2001). This process continued throughout the first term. By the end of Chiluba's first term, the government was perceived as being increasingly corrupt, preoccupied with squandering resources on patronage politics, and less committed to economic and political reforms (ibid.).[43] Indeed, by 1996 donors withheld balance of payments support because they

[42] It is difficult to quantify the number of people that are involved in petty training and the growth in this group. However, anecdotal evidence as well as numerous interviewees have confirmed that there has been significant growth in the number of cross-border and petty traders and that the growth in their number seems to be correlated with trade reform and easing of barriers to importation.

[43] Chiluba and many of his cronies are currently under arrest. He alone has 150 charges concerning theft of public funds against him (Economist 2003).

perceived the government's actions as signaling its declining commitment to the principles of good governance. Of particular concern to the donors was a constitutional amendment passed by the government that excluded the main opposition party candidate, Kenneth Kaunda, from contesting the 1996 elections and the use of government resources by the MMD to promote its electoral prospects (Rakner et al. 2001). Rakner et al. (2001) argue that "in 1996 economic policymaking became subordinated to political objectives – most notably, winning the 1996 elections. The second Chiluba government (1996-2001) became more inward-looking, predatory, and patrimonial in nature. The creation of a Presidential "slush fund" and the increased concentration of power in the presidency are evidence of the increased. Since 1996 Zambia's performance in governance has continued to decline and levels of government corruption have increased (Rakner et al. 2001).[44]

"Reports of widespread corruption during the ten-year reign of President Chiluba have been publicized in the state and non-state media since the 'New Deal' government of President Mwanawasa came into office late in 2001. It is worth pointing out that the agenda of reform pursued by the MMD government since 1991 failed to address the fundamental structural determinants of corruption and patronage as well as the impact of these interrelated vices on good governance. Indeed, if anything, the withdrawal of state intervention in economic governance may have increased rather than decreased the scope for corruption. The freeing of market forces appears to have weakened the regulatory capacity of the state, while privatization has afforded opportunities for the political elite to acquire public assets cheaply or fraudulently, and market forces have not measurably reduced the charging of gate-keeping rents or bribes. Despite the initial hopes of the ruling Movement for Multiparty Democracy, development policy remains too often determined by the extent to which government plans overlap with personal enrichment projects. It is in light of this background that the 2001 global corruption survey of the Berlin based non-government organization, Transparency International (TI), which ranks countries on both a bribe payers and Corruption Perception Index (CPI), and is based on several independently conducted surveys, rates Zambia as the second most corrupt country in Southern Africa. This ranking confirms that Zambia is regarded as a place where corruption in public and business life is widespread. There is therefore an urgent need to develop strategies that de-link private resource accumulation through corruption from access to public office through politics."

DAI. 2002. *The Development Context of Zambia: An Update and Analysis, with Lessons Learned and Recommendations for USAID's Next Strategy Plan.*

Duncan et al. (2003) argue that while varying degrees of patrimonialism have traditionally existed in Zambia, this pattern of politics is responsible for having held Zambian society together. However, the costs to Zambia have been high: poor economic growth and the weak public and private institutions. Patrimonial systems breed corruption, which "hinders economic growth, discourages foreign private investment and dissipates resources available for infrastructure, public services, and to combat poverty. Corruption affects the poor by forcing them to pay for essential public services that should normally be free" (Mulikita 2002). As a result, the potential for economic growth and poverty reduction is severely compromised.

[44] Transparency International began including Zambia in its Corruption Perceptions Index in 1998. Zambia's score on the index was 3.5 in 1998 and 1999; 3.4 in 2000; and 2.6 in 2000 and 2001. The index measures corruption as seen by business persons on a scale from 1 to 10, with 10 indicating the absence of corruption. Zambia's decreasing score over this period thus indicates worsening corruption. This is not surprising given the allegations of increasing corruption during Chiluba's term in office and of the massive vote rigging and electoral fraud in the 2001 elections, which brought President Levy Mwanawasa to power.

An independent Anti-Corruption Commission (ACC) was established in 1986 with a strong mandate to fight against corruption. However, its mandate was amended in 1996 and its power significantly watered down. There are some significant weaknesses of the ACC such as the lack of protection for whistleblowers and the fact that its record has been marred by political interference (Transparency International 2002). The problem of political interference in ACC's work was especially prominent under Chiluba. However, under Levy Mwanawasa the ACC has been more assertive and there seems to be less political interference in its work. Indeed, "the ACC is widely believed to be performing well, in good measure because of active support from the President, combined with wide support from citizens, parliamentarians, civil society organizations and the media with donor assistance" (Duncan et al. 2003). The previous statement highlights a critical element to fighting corruption: the need to involve both civil society and public sector institutions in the fight against corruption. Strengthening the oversight capacity of parliament may be an avenue to yield productive promise. Furthermore, corruption and bad governance can be checked more effectively through the reform of laws and the strengthening of governance institutions (DAI 2002).

CHAPTER SIX
CONCLUSIONS

Since Independence the Zambian economy has experienced a tragic and severe decline in its fortunes: real GDP per capita declined an astounding 42 percent since 1964 and poverty incidence increased, reaching 73 percent in 1998. The elections of 1991 ushered in the reformist-minded government of Chiluba, which was initially committed to undertaking deep reforms aimed at achieving sustainable growth and poverty reduction by transforming the Zambian economy from an inward-looking, state-dominated economy to an open, market-oriented, private sector driven economy.

Unlike many of its neighbors in the Sub-Saharan region who took a gradual approach to stabilization and structural adjustment, the Chiluba government originally moved quickly forward with stabilization and certain aspects of structural adjustment and trade such as agricultural and financial liberalization. Indeed, by the mid-1990s, the fundamental aspects of the reforms (with the exception of privatization of the mines and public sector reform) had been put in place. The reforms did have some positive effects on the economy: hyperinflation was arrested (although inflation is still high and continues to hover around 20 percent); there was some diversification of an originally mono-crop agricultural sector; and financial deepening seems to be occurring, driving growth in parts of the service sector. However, growth and poverty outcomes since the initiation of reform have been mixed: average annual real GDP per capita decreased by close to 2 percent between 1991 and 2000, and the poverty incidence increased by more than 3 percent over the same period. Disaggregating poverty incidence uncovers distinct patterns: rural poverty has decreased, while urban poverty has increased. And, although the average growth trend between 1991 and 2000 as a whole has been discouraging, this was due to a significant contraction in the first half of the decade, partially offset by a slight increase in the latter half. The modest but continuing growth acceleration since 1998 provides some grounds for optimism. Still, it is important to understand what explains the average poor economic performance and increasing poverty in Zambia since SAP was undertaken.

One obvious factor has been the continuing decline in revenues from copper throughout the decade. The growth of the non-copper sector has been reasonably impressive since the mid-1990s, growing an average of approximately 5.5 percent over 1995-2001. During the early 1990s, the overvaluation, high interest rates, and disarray in agricultural policy were no doubt contributors to the stagnation of the non-copper sector. By the latter 1990s, the most negative of these effects were past and some of the benefits of stabilization and adjustment may have contributed to the decent growth which occurred. An additional drag on the economy's performance, albeit a hard one to measure quantitatively, has been the HIV/AIDS epidemic; its negative impact probably increased as the decade went on.

The above caveat aside, there is no doubt that part of the blame for the weak GDP growth lies with weaknesses in the design and implementation of Zambia's SAP. The fact that interest rates reached levels of more than 100 percent as a result of stabilization measures is one indication of design problems. Little thought seemed to have been given to policy coordination and the proper pace and sequencing of reforms, so it was not uncommon for reforms that worked at cross purposes to be undertaken simultaneously. Zambia's early experience with maize marketing liberalization highlights this tendency. Although stabilization measures and financial liberalization were needed, they subverted the maize marketing reforms and thereby negatively impacted the rural poor.

The poor reform design was, in part, due to Zambia's adoption of the standard SAP model promoted by the IFIs at the time. This model was not tailored to the needs of the Zambian economy and was probably too simplistic: it merely pushed countries to stabilize and liberalize all sectors in short order. The example of trade liberalization in Zambia illustrates this point well. The total removal of protection during a time when the Kwacha was appreciating (as a result of the liberalization of the foreign exchange and capital markets) and neighboring countries were not complying with the negotiated trade agreements had a negative impact on the competitiveness of Zambian exporters. Zambia's experience calls into question the wisdom of failing to maintain some level of protection in the context of an appreciating and ultimately overvalued exchange rate and of trading partners that do not comply with trade agreements.

A further example of the lack of sophistication of the reforms was the absence of a built-in mechanism to allow them to adjust to external shocks (such as droughts and declining copper prices), an all too common phenomenon affecting the Zambian economy. The 1992 drought was more damaging than necessary to the economy and to rural poor in particular because the government continued its strict stabilization measures rather than adjust them to account of the shock. Zambia's delay in privatizing the copper mines despite the fact that the collapsing copper prices increased the urgency of doing so is another example of its inability to adjust to changing reality. The government's gradualist approach to the privatization of ZCCM ended up raising the cost to it of the drain on the government budget, lowering the final sale price and potentially creating more redundancies. Given the importance of the mining industry to the Zambian economy, this all proved to be a significant obstacle to economic growth. Clearly, the lack of a sophisticated, coordinated reform policy able to adjust to external shocks was highly problematic.

Apart from design and implementation problems in policy areas they did address, the reforms failed to focus adequately on the crux of Zambia's problem: the dire need to diversify away from copper dependence. While the problem of Zambia's copper dependence and thus the need to diversify the economy was acknowledged, the SAP did not seem to address in the detail necessary the specifics of how this could be achieved. Given the limited domestic demand and the need to create employment opportunities, it was apparent that promotion of non-traditional exports was in order. While the government initiated a few incentives for exporters, such as tax breaks, it was not able to get the key issue right, namely, exchange rate management. The liberalization of the exchange rate combined with capital market liberalization (in a region where other capital markets were not liberalized) and exorbitantly high interest rates resulted in an appreciation of the Kwacha beginning in 1993. This was disastrous for exporters who also had to contend with some of the highest production costs in the region. While non-traditional exports have increased since liberalization, they are far from being able to make up for the loss in copper export receipts. It is clear from the Zambian experience that sound exchange rate management is particularly important in a Dutch Disease economy, hoping to diversify its range of exports.

In addition to diversifying its exports, it was important that on a more fundamental level Zambia diversify the structure of its economy. Agriculture was rightly seen as the sector with the potential to be a driving force in the economy. Additionally, getting agriculture going is understood as critical to reducing rural poverty. Agricultural policy, however, has been characterized by a lack of clarity throughout the 1990s. Agricultural input and output marketing continue to be a mess. This is especially problematic for poor farmers in remote rural areas because they are not able to access needed inputs or markets (World Bank 2003). Consequently, many are forced to remain outside of the market, producing merely for their subsistence. The collapse in expenditure on transport and communications as a result of austerity measures further accentuated the difficulties already faced by remote rural farmers by raising the cost of the private sector to provide credit, inputs, and marketing services to them. Systematic policies to promote crop diversification and marketing of non-traditional crops are not in place. Extension services are of poor quality. The government's on again, off again export ban on maize has skewed incentives for producers. In addition, food security and thus food aid policy is critical in drought-prone Zambia. There is anecdotal evidence, however, that food aid may have had some adverse effects on the agricultural market by impacting maize prices and significantly skewing producer incentives. This issue warrants further study. Trade liberalization has brought further challenges as import-competing agricultural products and processed food reduce Zambian farmers' share of an already small market. Admittedly, farmers have fared better since the 1991 (largely as a result of trade reform that allowed them to take advantage of unusually high international prices for agricultural products in the early half of the 1990s and some improvements, albeit uneven, in marketing), their level of poverty is still staggeringly high. In order for the agricultural sector to achieve its potential in terms of contributing to economic growth and poverty reduction a systematic and comprehensive agricultural policy must be developed and implemented that overcomes the aforementioned obstacles.

A third flaw in the SAP program was the government's exaggerated expectations regarding the ability of the private sector to fill the vacuum of the retreating public sector. The more than two decades of socialist policies had resulted in a small and weak private sector. In addition, unexpected results of the reform such as the prohibitively high cost of credit severely limited the potential for the private sector to engage in productive activities while providing them incentives to channel their resources towards unproductive investments (i.e., high-yielding, low-risk Treasury bonds). Further, uncertainty regarding government policy (especially in the maize market where it would intervene at unpredictable times) further discouraged an effective private sector supply response. Since the success of the reform was predicated upon such a response, the private sector's modest capacity limited Zambia's growth potential.

Fourth, increasing government corruption and waning government commitment to reforms undermined the potential growth and poverty reducing impact of the reforms. Corruption had a pernicious effect on the economy because it converted potentially productive and poverty reducing resources into unproductive rents. The government's diminishing commitment to reforms was evident by the mid-1990s. By that point, the reforms had borne little fruit. This contributed to the loss of government enthusiasm for them and thus increased the unevenness of their implementation.

Given all of these problems, how was Zambia able to achieve moderate growth in the non-copper sector since the mid-1990s? Is the growth trend sustainable? Recently, the service sector has been the main engine of growth of the Zambian economy. More specifically, the financial sector, retail and wholesale, and real estate have driven much of the non-copper sector's growth. Growth in the financial sector has come about as a result of the financial sector reforms, which facilitated the development of new forms and types of financial institutions and services. Growth in real estate has been a result of privatization, the Land Law of 1995, and the flight to non-financial assets as a result of loss of confidence in local banks. It is interesting to note that despite the fact that the 1995 Land Law did little to solve the significant problems associated with property rights in Zambia, the little that it did accomplish had a big impact. Getting property rights and/or control rights straightened out in Zambia has the potential to spur significant growth. Privatization has opened up the wholesale and retail sub-sector to privately owned outlets, which are able to reach all of Zambia and offer a much wider variety of consumer goods than previously available. Informal sector trading has also grown tremendously as a result of import liberalization. Many of Zambia's urban poor were forced to get involved in informal sector activities as a result of shrinking formal sector employment and the lack of a social safety net. While informal sector activities have not on balance been able to lower the incidence of urban poverty they have contributed to the decreasing depth and severity of that poverty. Given the increasing incidence of urban poverty, it is important that Zambia develop a well-targeted social safety net.

Although the recent growth of the non-copper sector is encouraging, its sustainability and thus that of overall growth is unclear. The growth in financial services is a good sign and indicates that this sector may continue to grow. On the other hand, it is clear that Zambia cannot count on continuation of the strong recent growth in retail and informal sector trade, related to the one-shot effects of liberalization; in the medium and longer run this sector's growth is closely tied to overall GDP growth. In order to achieve sustainable pro-poor growth the government will have to promote stable employment creation through the further diversification of the formal economy and a strengthening of the productive capacity of the informal sector.

To generate sustainable pro-poor growth Zambia must, among other things, develop non-traditional labor-intensive exports. Since, after copper, Zambia's comparative advantage lies in agriculture, promotion of that sector and the labor-intensive, export-oriented agro-processing industries will need to be an important component of pro-poor policy. It is critical, therefore, that Zambia develop a sound agricultural sector policy that is able to guide this sector's growth. Such a policy should get the prices (especially of credit and of maize) and incentives right while recognizing the importance of investing in key public goods such as rural marketing, extension services, and infrastructure.

While the key to pro-poor growth is ensuring that sufficient numbers of poor people have access to stable and well-paying employment opportunities, Zambia is now operating in the context of a serious HIV/AIDS epidemic where the productive capacity of significant number of people may be so compromised that many of these employment opportunities out of their reach. It is therefore critical to consider the impact of the epidemic on growth, what the barriers to employment and income generation engendered by HIV/AIDS might be, and the means by which they can be overcome.

APPENDIX 1

SELECTED ECONOMIC REFORMS

Box 1. Selected Economic Reforms, 1991-1994

<u>1991</u>

- Substantial reductions of subsidies on maize meal and fertilizer.
- Exchange rate system liberalized.
- Government announces commitment to privatization.

<u>1992</u>

- Nontraditional exporters allowed 100 percent foreign exchange retention.
- Official exchange rate devalued by 30 percent.
- Subsidies on mealie meal eliminated.
- Controls on all prices eased, most eliminated.
- Pan-territorial pricing for maize eliminated.
- Phase I of government’s redundancy program –12,000 contract daily employees made redundant.
- Borrowing and lending rates decontrolled.
- Trade and industrial policy reform initiated.

<u>1993</u>

- Cash budget system introduced to reduce the budget deficit.
- Treasury bill introduced.
- Pan-territorial floor price for maize introduced.
- Government withdrawal from marketing of agricultural inputs announced.
- Fiscal reform measures introduced.
- Elimination of import and export licenses.
- Elimination of all restrictions on bank lending and deposit rates.
- Establishment of Lusaka Stock Exchange.
- Markets for maize and fertilizer opened to full competition.
- General reduction in tariffs and excise taxes.
- Public Sector Reform Program launched.

<u>1994</u>

- Semi-autonomous Zambia Revenue Authority created.
- Kwacha made fully convertible.
- Increase in the reserve ratio.

Source: Adapted from World Bank 2001.

APPENDIX 2

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